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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

STATE OF DELAWARE,
Plaintiff,
and
STATE OF TEXAS,
Intervening Plaintiff,
v.
STATE OF NEW YORK,
Defendant.

On Exceptions to the Special Master's Report

EXCEPTIONS AND BRIEF IN SUPPORT FOR PLAINTIFF, STATE OF DELAWARE

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EXCEPTIONS OF PLAINTIFF, STATE OF DELAWARE, TO THE REPORT OF THE SPECIAL MASTER

Delaware commenced this action in 1988 to recover money and other intangible property wrongfully escheated by the State of New York; Delaware's claims are based on this Court's decisions in *Texas* v. *New Jersey*, 379 U.S. 674 (1965), and *Pennsylvania* v. *New York*, 407 U.S. 206 (1972).

In *Texas* v. *New Jersey*, this Court established a "clear" rule designed to settle "once and for all" the competing claims of states to escheat intangible property. 379 U.S. at 678. The Court held that unclaimed intangible property is subject to escheat "only by the state of the last known address of the creditor, as shown by the debtor's books and records." 379 U.S. at 681-82. Where there is

no record of an owner or address ("owner/address unknown"), or where the last known address is in a state that does not provide for escheat of the property, the Court held that a "backup rule" applies: the state of the debtor's corporate domicile (determined by its state of incorporation) was to have the right to escheat. 379 U.S. at 682; Decree, 380 U.S. at 518. In *Pennsylvania* v. *New York*, the Court declined to depart from the rule of *Texas* v. *New Jersey*, 407 U.S. at 210, 213-16.

The property at issue in this case consists of dividends, interest, and other distributions in respect of securities (generally, "distributions") held by securities brokers and other recordholders holding securities for the accounts of beneficial owners after those distributions have been paid by the issuers of the securities to the holders of record. Under universally-accepted doctrines of corporation and commercial law—identical in all material respects in every state in the Union—once these distributions are paid to the record owners, the issuers no longer have any right, title or interest in them and are discharged from liability with respect to them.

For many years, New York has collected these distributions from brokers and other similar parties having offices in New York. Delaware disputes New York's right to do so in certain cases, saying that where the property is "owner/address unknown" and is held by brokers that are Delaware corporations, it should be escheated to Delaware under the rule of *Texas* v. *New Jersey*. New York's position—rejected by the Special Master—is that property that appears to be "owner/address unknown" actually is not, since all the unknown owners are "statistically" presumed by New York to be "other brokers" with "trading addresses" in New York.

Starting in January 1989, and through March 1992, forty-eight additional states and the District of Columbia appeared in this action and moved to intervene. Most of the intervening plaintiffs argued for an inter-

pretation of "debtor" that viewed the recordholders of the securities—and thus the parties holding the unclaimed funds—as "transparent" and without legal relevance, so that the *issuer*, rather than the recordholder and holder of the funds—should always be deemed to be the "debtor" under *Texas* v. *New Jersey*. Those intervening states did not seek to overturn the rule that in "owner/address unknown" cases, the state of incorporation of the "debtor" (as they construed "debtor") was to be considered the debtor's domicile. A smaller group of states, led by California, argued for a more radical "interpretation"—actually, an overruling—of *Texas* v. *New Jersey*.

All these theories were directed to the "backup rule." The intervening plaintiffs sought to expand the scope of the case beyond the property sought by Delaware in its complaint—to all of the distributions seized by New York other than those which had flowed from New York-incorporated issuers, apart from "owner/address *known*" abandoned distributions. But no state sought to argue that the case be expanded to cover "owner/address *known*" unclaimed or abandoned distributions or securities or that the "primary rule" applicable to them should be changed.

Motions for judgment on the pleadings were referred to the Master, who has filed a report (the "Report") recommending that: (1) the term "debtor" should be interpreted to mean the issuer of the particular security on which distributions have been paid, rather than the holder of the distributions in question; and (2) the backup rule should be changed, so that a corporation's "principal executive office," rather than its state of incorporation, will be considered its domicile.

Delaware excepts to the Report as follows:

1. *Equation of "Issuer" with "Debtor."*—The Report misinterprets *Texas* v. *New Jersey* and *Pennsylvania* v. *New York* by asserting that in formulating its rules of priority the Court used the terms "debtor" and "creditor"

merely as "an attempt to identify the relevant parties" rather than as a "prescriptive legal command[]." Report 29. Delaware submits that the Report's recommendation in this regard does not comport with the ordinary meaning of the words "debtor" and "creditor," is inconsistent with universally-accepted state and common law and with the principles underlying the *Texas* rule, and changes the law in an area where the law should be settled.

All parties agree that under relevant state law (in all 50 states and the District of Columbia), once an issuer has made a distribution to a nominee (or other) record owner of the security, the *issuer* no longer has any right or interest in the distribution; and that by paying the recordholder the issuer has discharged its obligation and is no longer a "debtor" as that term is commonly understood (one who owes something to another). All parties agree that since the non-record beneficial owner may not look to the issuer for payment, such an owner is not a "creditor" of the issuer, only of the nominee. In the ordinary meaning of the words, the nominee in whose hands the funds have become "owner/address unknown" is a "debtor"—it owes the distribution to the beneficial owner, who either is unknown or unlocatable. The Master, however, recommended that the word "debtor" be construed in accordance with "federal common law" and discovered that under "federal common law" the issuer was the "debtor," although it did not have that status under the law of any of the 50 states. To this finding and conclusion, Delaware excepts.

2. *Substitution of "State of Principal Executive Office" for "State of Incorporation."*—The Report also errs in recommending that the rule adopted in *Texas* v. *New Jersey* and adhered to in *Pennsylvania* v. *New York* be "modified" so that the debtor's domicile is no longer considered its state of incorporation, but instead the state of location of its principal executive office.

Delaware excepts to this recommendation. Departing from the rule of corporate domicile here would be in-

consistent not only with this Court's precedents, but with fundamental principles of jurisprudence defining the relationship between the sovereign and its corporate citizens and the power of the sovereign over unclaimed property—principles that have retained their vitality for hundreds of years. At bottom, the Report recommends that these historical and legal principles be cast away in favor of a system that—in the Master's view—is more "fair" because it spreads moneys among more parties.

Both recommendations violate the rule of *stare decisis*. This Court has explained that "[a] litigant who in effect asks us to reconsider not one but two prior decisions bears a heavy burden of supporting such a change in our jurisprudence." *Walker* v. *Armco Steel Corp.*, 446 U.S. 740, 749 (1980). While a "compelling justification" must always be presented for that reconsideration, *stare decisis* has "added force" where Congress has had many years to correct a decision and where public and private parties have relied on the unmodified rule. *See Hilton* v. *South Carolina Pub. Rys. Comm'n*, 112 S. Ct. 560, 564 (1991).

3. *Erroneous Findings of Fact or Failures to Find.*—Delaware excepts to the Report's findings of fact as erroneous in the following respects:

First, a fundamental factual error permeates the Report: it misleadingly suggests that all so-called "intermediaries" are legally alike; it therefore treats recordholders as if they were paying agents, and ascribes no legal relevance to their status as record security holders. Indeed, the Report seeks to make "the intermediaries as 'transparent' as possible." Report 36.

Paying and transfer agents are agents of the issuer, and their relationship with the issuer is contractual; the issuer, by contract or common law principles of agency, has a claim to the funds in the hands of its paying agent that cannot be paid to their owner. In contrast, the recordholder is not the issuer's agent, and it has legal title to

the distributions. Moreover, its claims are superior to all but those of the beneficial owner; brokerage houses are not the agents of issuers, and the issuers may not look to them for recovery of distributions unclaimed by their beneficial owners.

Many of the Findings of Fact are contaminated by a glossing over of these important legal distinctions and by a failure to recognize the legal status and property rights of the recordholders. Delaware therefore takes exception to Findings 4, 7, 9, 13, 14, 15, 16, 17, 24, 25, 28, 34, 35, 36, 48, 49, 58, 69, and 72, and to "Metafacts" A, B, C, and D.

Moreover, the record establishes that stockbrokers keep the interest they earn on unclaimed intangible property and account for such property as an asset (with a concomitant liability to the unknown beneficial owner). *See* Brief, *infra* pp. 29-30 & n.34. The Report erroneously fails to make a finding to this effect.

Second, the Report erroneously concludes that the "location of the principal executive offices of an issuer is, in almost all cases, ascertainable from standard sources." Report B-24 ("Metafact" G). As demonstrated in Delaware's submissions to the Master,[1] the location of a "principal executive office" is a factual question that requires a careful review of the relevant facts (often including the testimony of witnesses) and must be determined case by case. In its submissions to the Special Master, Delaware identified 94 companies that—according to two computer databases with data taken directly from SEC disclosure statements—had more than one principal executive office reported during the same period of time; that number more than doubled when other standard reference sources were also compared; and Delaware identified 785

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[1] Letter from Richard L. Sutton to Thomas H. Jackson (Aug. 13, 1991) at 6-11; Supplemental Brief of Delaware (Nov. 4, 1991) at 5-21 and Appendix thereto; Affidavit of Jeffrey Bossert Clark (Nov. 4, 1991) and Exhibits thereto.

companies that changed principal executive offices in the years 1988 to 1991, according to public reference sources. If the "state of principal executive office" test is to be substituted for the "state of incorporation" test with respect to corporations that are not issuers of securities, the Master's finding, of course, breaks down even more seriously. In any event, Delaware excepts to this finding.

4. *Denial of Discovery.*—The Report erred in concluding that no discovery was needed to determine the consequences of the new rule substituting the "state of incorporation." Delaware excepts to the Master's failure to grant its request for discovery, made after the Master circulated a "Draft Report" indicating his disposition to recommend this rule change. The Master considered such discovery "pointless." Discovery Order No. 15 (Jan. 28, 1992) at 1. The Master did not pause to consider whether evidence should be received on the subjects of: how the listing of a "principal executive office" with the SEC bears any rational relationship to the commercial activity of the issuer and its subsidiaries; the proper treatment of unregistered issuers (such as federally-chartered organizations); the comparative practical burdens of and justifications for a "state of incorporation" and for a "principal executive office" test; the reliance of the states on the existing rule and the dislocation that would be caused by changing it; or how his recommendation to overturn *Texas* v. *New Jersey* would affect cases where the entity holding unclaimed intangible property does not list *any* principal executive office with the SEC, including the feasibility of applying the "principal executive office" test outside of the context of issuers of securities.

5. *Retroactivity.*—The Report errs in apparently applying all aspects of its recommendations retroactively. In his Draft Report, the Master stated:

> If the backup rule is modified, such as by substituting a chief executive office test for the existing state of incorporation test, I believe that the rule could be applied without difficulty, in this case, to the funds held by intermediaries, not yet possessed by any state. On the other hand, such a change in a rule should not upset funds already escheated, in other cases (or circumstances), in reliance on the backup rule as it currently exists, with a jurisdiction of incorporation test. Thus, I would have any change in the backup rule be non-retroactive to that extent.

Draft Report 57 n.64.[2] Yet the final report contains no language comparable to that quoted from the Draft Report and appears to contemplate a complete retroactivity of the new rules (whether admittedly new or unadmittedly so) that it recommends. Retroactivity would unjustly fall on Delaware which has relied on the backup rule to escheat unclaimed property in the hands of its corporate citizens. Were the Court to agree that the rules are to be changed as recommended by the Master, Delaware takes exception to any such retroactivity.

6. *Failure to Recommend Alternative Conclusion.*— The Report errs in failing to conclude expressly that, if (contrary to the Master's recommendation) the brokers are held to be "debtors" and the traditional rule of corporate domicile under *Texas* v. *New Jersey* is applied, Delaware is entitled to recovery from New York in accordance with its Complaint. This conclusion is implicit in the Report's correct rejection of New York's position, and Delaware excepts to the failure of the Report to recommend a specific conclusion to this effect and asks this Court so to conclude.

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[2] Indeed, all but the Texas subgroup agreed. Supplemental Submission of Alabama, *et al.* (Nov. 4, 1991) at 29 n.19; Supplemental Reply Submission of California, *et al.* (Nov. 21, 1991) at 18-19.

In support of the foregoing exceptions, Delaware submits the attached Brief.

Respectfully submitted,

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BRIEF IN SUPPORT OF EXCEPTIONS
FOR PLAINTIFF, STATE OF DELAWARE

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 111 Original

STATE OF DELAWARE,

Plaintiff,

and

STATE OF TEXAS,

*Intervening Plaintiff,**

v.

STATE OF NEW YORK,

Defendant.

On Exceptions to the Special Master's Report

BRIEF IN SUPPORT OF EXCEPTIONS FOR PLAINTIFF, STATE OF DELAWARE

JURISDICTION

The original and exclusive jurisdiction of this Court rests upon Article III, section 2, of the United States Constitution and upon 28 U.S.C. § 1251(a).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS

The texts of the following provisions are found in Appendix A to this Brief: United States Constitution, art. I, § 8, cl. 3, art. IV § 1, and amend. XIV, § 5; 12 U.S.C.

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* All of the other states and the District of Columbia have also sought intervention.

§§ 2501 to 2503; Uniform Unclaimed Property Act (1981) §§ 1, 2, 3, 11, 12, 17, 19, 20, 25, 26, 33; Uniform Disposition of Unclaimed Property Act (1966 revision) §§ 1, 5, 7, 9, 10, 11, 13, 14; Uniform Commercial Code §§ 8-207, 9-103; Model Business Corporation Act, §§ 1.40 (21), 7.07, 7.23; New York Abandoned Property Law Articles V and V-A; Securities and Exchange Commission Rules 14a-7, 14a-13, 14b-1, 14b-2, 14c-7, 15c3-2, 15c3-3(e), and 15c3-3 (Exhibit A).

STATEMENT

1. *The Rule of Texas* v. *New Jersey*.—This Court has long recognized the power of the sovereign to take title to abandoned personal property (*bona vacantia*), a power with deep roots in the common law. *See, e.g., Late Corp. of the Church* v. *United States*, 136 U.S. 1, 56-57 (1890); *Society for Propagation of Gospel in Foreign Parts* v. *Town of New Haven*, 21 U.S. (8 Wheat.) 464, 487-88 (1823).

Because this power, now called "escheat,"[1] rests on historical traditions of territorial jurisdictional power—power that may be exercised by multiple sovereigns when a single entity holding intangibles is found in multiple states—conflict among states over the escheat of intangibles became acute. *See Standard Oil Co.* v. *New Jersey*, 341 U.S. 428 (1951); *id.* at 443-45 (Frankfurter, J., dissenting); *Connecticut Mut. Life Ins. Co.* v. *Moore*, 333 U.S. 541, 552 (1948).

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[1] Rightly or wrongly so-called; early in the common law's development, the term "escheat" referred to the return of land to the feudal lord upon conviction of felony, or upon death without heirs, and *bona vacantia* was the name given to the sovereign's acquisition of personalty. *See infra* p. 34 n.39. In addition, most, but not all, states' unclaimed property statutes do not provide for "escheat" in the sense of cutting off title but are merely "custodial" in nature; a few cut off the former owners' title. Ky. Rev. Stat. Ann. § 393.020 (Michie 1984); Mich. Comp. Laws Ann. § 567.14 (West 1967); N.C. Gen. Stat. 116B-2 (1991); Wyo. Stat. 9-5-202 (1977).

In *Connecticut Mutual Life*, the Court held, over three dissents, that New York might, consistent with the Due Process Clause, escheat unclaimed life insurance proceeds on policies issued on the lives of New Yorkers by insurance companies incorporated outside New York. The Court noted that the claims of other states were not before the Court. 333 U.S. at 548. Justice Frankfurter dissented, arguing that "[w]e ought not to decide any of these interrelated issues until they are duly pressed here by the affected States." 333 U.S. at 555. Justice Jackson put the matter even more forcefully. First, he noted that "[e]scheat survives only as an 'incident of sovereignty,'" 333 U.S. at 560 (dissenting opinion) (quoting *In re Melrose Ave.*, 136 N.E. 235, 237 (N.Y. 1922) (Cardozo, J.)), and discussed why the "two usual examples of escheat" (sovereign power over property and over persons) did not apply to New York's efforts to escheat in that case. 333 U.S. at 560-63. He concluded that the Court should fashion a general rule: "[w]hile we may evade it for a time, the competition and conflict between states for 'escheats' will force us to some lawyerlike definition of state power over this subject." 333 U.S. at 563.

In *Standard Oil Co.* v. *New Jersey*, 341 U.S. 428 (1951), the converse situation was presented, and the Court held that New Jersey's escheat of intangible property held by Standard Oil, a New Jersey corporation, comported with the requirements of the Due Process Clause and the Full Faith and Credit Clause: "stock certificates and undelivered dividends thereon may . . . be abandoned property subject to the disposition of the domiciliary state of the corporation." 341 U.S. at 442. Four justices dissented on the ground that other states' competing claims should be considered. *Id.* at 443-45.

In *Western Union Telegraph Co.* v. *Pennsylvania*, 368 U.S. 71 (1961), the Court again confronted (for the third time in thirteen years) a dispute over unclaimed intangible property potentially subject to competing states' escheat claims—this time, unclaimed Western

Union money orders. The Court held that Pennsylvania could not exercise dominion over unclaimed money orders purchased in that state unless other states would also be bound by the judgment. The Court recognized the need for a uniform and binding set of rules governing competing claims to escheat intangible property and invited the states to invoke the Court's original jurisdiction to resolve the issue, observing that it was "imperative that controversies between different States over their right to escheat intangibles be settled." 368 U.S. at 79.[2]

Soon after, several states accepted the Court's invitation and filed such actions. In *Texas* v. *New Jersey*, 379 U.S. 674 (1965), the Court was squarely presented with competing claims of more than one state to abandoned intangible property—"a question which should be settled once and for all by a clear rule which will govern all types of intangible obligations like these and to which all States may refer with confidence." 379 U.S. at 678.

At issue were, nominally, "various small debts" of Sun Oil Company that "small creditors" had not shown up

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[2] This line of cases came to the Court in the appellate jurisdiction from state courts in cases in which the parties were (a) the state seeking escheat and (b) the holder of the property sought to be escheated (generally a corporation). The opinions discuss several due process considerations—the power of the state seeking escheat to exercise dominion over the intangibles in question, the adequacy of notice provided to the creditors, and the substantive due process rights that protect the holder from having to pay twice, if someone with a better claim later turned up. This claimant was generally envisioned to be the "real owner" of the property, that is, the private party who would assert that she had not abandoned the intangibles in question. The theory was that unless the escheat process protected the holder from having to pay twice, the Due Process Clause was violated. *See Security Sav. Bank* v. *California*, 263 U.S. 282, 284 (1923); *Anderson Nat'l Bank* v. *Luckett*, 321 U.S. 233, 242-43 (1944). The 1961 *Western Union* case applied this principle to competing claims by more than one state to escheat the same property, by refusing to permit escheat at the instance of one state until other states' claims could be considered.

to collect or had not cashed checks for. They were of many varieties: uncashed checks payable to third-party creditors, uncashed wage checks, uncashed royalty payments to lessors of oil- and gas-producing land, unclaimed fractional mineral interests, uncashed dividend checks, and undelivered fractional stock certificates resulting from stock dividends. 379 U.S. at 675-76 & n.4. The case itself involved only $27,000, even in the money of that day hardly enough to justify resort in economic terms to this Court's processes. But the case was obviously a test case, and the Court treated it as such, disposing of the issues in broad and clear terms, intended to be applied generally.

The Court began by recognizing that a number of rules for determining the priority of the states' claims to intangible property—various types of debts—might be permissible, and it considered four of them.

It declined the invitation of the State of Texas to evaluate which state had the "most significant 'contacts' with the debt." 379 U.S. at 678. Indeed, the Court rejected "*any* test which would require us in effect either to decide each escheat case on the basis of its particular facts or to devise new rules of law to apply to ever-developing new categories of facts." 379 U.S. at 679 (emphasis supplied).

The Court also declined to adopt a rule looking always to the "domicile of the debtor" (*i.e.*, its state of incorporation), notwithstanding "the obvious virtues of clarity and ease of application." 379 U.S. at 679-80. And the Court declined to adopt a "principal office," "main office," or "principal place of business" of the debtor test: "[a]ny rule leaving so much for decision on a case-by-case basis should not be adopted unless *none* is available which is more certain and yet still fair." 379 U.S. at 680 (emphasis supplied).

Instead, the Court concluded that "since a debt is property of the creditor, not the debtor, fairness among

the States requires that the right and power to escheat the debt should be accorded to the State of the creditor's last known address as shown by the debtor's books and records." 379 U.S. at 680-81.

The Court also adopted a "backup rule." Where there is no record of an owner or address ("owner/address unknown"), or where the last known address is in a state that does not provide for escheat of the property, the state of the debtor's corporate domicile was to have the right to escheat. 379 U.S. at 682. The decree entered afterwards, upon consideration of the positions of the respective parties as to its terms, made it plain that "corporate domicile" meant the corporation's state of incorporation. Decree, ¶ 2, 380 U.S. at 518.

2. *Pennsylvania* v. *New York (Western Union)*.—In *Pennsylvania* v. *New York*, 407 U.S. 206 (1972), Pennsylvania, through an original action, renewed its efforts to escheat part of Western Union's unclaimed money order proceeds in situations where neither the payee nor the sender could be located (or in situations where drafts issued in payment or refunded were not negotiated). *Pennsylvania* v. *New York*, 407 U.S. at 207-08. Special Master John F. Davis[3] recommended that the *Texas* v. *New Jersey* rule be applied to all the items involved in the case. 407 U.S. at 212. "He found that '[a]s in the case of the obligations in [*Texas* v. *New Jersey*], [the *Texas*] rule presents an easily-administered standard preventing multiple claims and giving all parties a fixed rule on which they can rely.'" 407 U.S. at 213. Because of the apparent infrequency with which creditors' names and addresses appeared on Western Union's books and records, this recommendation contemplated that significant portions of the unclaimed money orders would escheat to New York, Western Union's state of incorporation.

Pennsylvania took exception, objecting to the likelihood that "the corporate domicile will receive a much larger

[3] Davis had served as the Clerk of this Court from 1961 to 1969.

share of the unclaimed funds here than in the case of other obligations." 407 U.S. at 214. The Court, in an opinion by Justice Brennan, stressed the importance of *stare decisis* and of fixed rules in this area, and rejected the exception:

> we do not regard the likelihood of a "windfall" for New York as a sufficient reason for carving out this exception to the *Texas* rule. . . . [T]he only arguable basis for distinguishing [this case from *Texas* v. *New Jersey*] is that [it involves] a higher percentage of unknown addresses. . . . [T]o vary the application of the *Texas* rule according to the adequacy of the debtor's records would require this Court to do precisely what we said should be avoided —that is, "to decide each escheat case on the basis of its particular facts or to devise new rules of law to apply to ever-developing new categories of facts."

407 U.S. at 214-15 (quoting *Texas* v. *New Jersey*, 379 U.S. at 679).

The Court thus reaffirmed the "backup rule" of *Texas* v. *New Jersey*, which it articulated as follows: "if [the creditor's last known] address does not appear on the debtor's books or is in a State that does not provide for escheat of intangibles, then the State of the debtor's incorporation may take custody of the funds 'until some other State comes forward with proof that it has a superior right to escheat.'" 407 U.S. at 210-11 (quoting *Texas* v. *New Jersey*, 379 U.S. at 682).[4]

Three Justices dissented because, in their view, "fairness" required "a relatively minor but logical deviation in the manner in which [the *Texas* rule] is implemented in this case." 407 U.S. at 219. The dissenters considered a strict application of the *Texas* rule to be "inflexible and

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[4] *See* Decree, 407 U.S. at 223-24 (superior right shown by "proof that the last known address was within that other State's borders"; or "if and when the law of the State of the last known address makes provisions for escheat or custodial taking of such property").

inequitable," 407 U.S. at 222, and thought that the rule should be "modified" for purposes of the case at hand. 407 U.S. at 220.

Two years after the Court's decision in *Pennsylvania* v. *New York*, Congress enacted legislation governing the disposition of money orders and traveler's checks. (Congress expressly excluded third-party bank checks and implicitly excluded all other intangibles.) Congress made an express finding of fact that "a substantial majority" of purchasers of money orders and traveler's checks reside in the states where such instruments are purchased, and also concluded that the cost of maintaining and retrieving addresses in the context of these instruments was a burden on interstate commerce. Pub. L. No. 93-495, Title VI, § 601, 88 Stat. 1500, 1525 (1974) (codified at 12 U.S.C. § 2501) (reprinted at App. A pp. 1a-3a). Congress therefore altered the holding of *Pennsylvania* v. *New York*—but only as applied to money orders and traveler's checks. Congress did not alter the fundamental *Texas* rule.[5] That Congress has the power to do so—whether under the Commerce Clause, the Full Faith and Credit Clause, or its authority to enforce the Due Process Clause of the Fourteenth Amendment under its Section 5—is beyond cavil. Indeed, the Court in *Texas* v. *New Jersey* appears to have contemplated that there might one day be an "applicable federal statute" that would broadly "settle this interstate controversy." 379 U.S. at 677. But no such general statute has been enacted in the nearly three decades since *Texas* v. *New Jersey* was decided.

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[5] Indeed, Federal Reserve Board Chairman Arthur F. Burns' letter to the Senate Banking Committee (made a part of the Committee Report) acknowledges the general applicability of *Texas* v. *New Jersey*; and the Committee adopted an amendment to the bill designed to insure that its reach would be limited to money orders and traveler's check *only*. S. Rep. No. 505, 93d Cong., 1st Sess. 2-3, 5-6 (1973) (bill should not be interpreted to cover third-party bank checks).

3. *Delaware* v. *New York*.—The rule of these two cases proved abiding—almost two decades passed before this case. During that time Congress has not disturbed the fundamental rules governing escheat of all types of intangible property—with the one exception for unclaimed money orders and uncashed traveler's checks. The rule has been applied to a variety of intangibles—uncashed checks,[6] unclaimed proceeds of class action recoveries,[7] unclaimed health and welfare benefits,[8] unclaimed insurance proceeds of all kinds,[9] trading stamps,[10] gambling winnings,[11] unclaimed refunds,[12] and of course unclaimed securities and dividends and interest on securities.[13]

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[6] *E.g.*, *Riggs Nat'l Bank* v. *District of Columbia*, 581 A.2d 1229, 1234-35 (D.C. 1990).

[7] *E.g.*, *Friar* v. *Vanguard Holding Corp.*, 509 N.Y.S.2d 374, 376 (N.Y. App. Div. 1986).

[8] *E.g.*, *Aetna Life Ins. Co.* v. *Borges*, 869 F.2d 142, 147-48 (2d Cir.), *cert. denied*, 493 U.S. 811 (1989).

[9] *E.g.*, *Employers Ins.* v. *Smith*, 453 N.W.2d 856, 863-64 (Wis. 1990) (workers compensation); *Louisiana Health Serv. & Indem. Co.* v. *McNamara*, 561 So. 2d 712, 717-18 (La. 1990) (health insurance); *Revenue Cabinet* v. *Blue Cross & Blue Shield of Ky.*, 702 S.W.2d 433, 434-35 (Ky. 1986) (same); *Treasurer & Receiver General* v. *John Hancock Mut. Life Ins. Co.*, 446 N.E.2d 1376, 1382-83 (Mass. 1983) (life insurance); *South Carolina Tax Comm'n* v. *Metropolitan Life Ins. Co.*, 221 S.E.2d 522, 523-24 (S.C. 1975) (same).

[10] *O'Connor* v. *Sperry & Hutchinson Co.*, 379 A.2d 1378, 1381 (Pa. Commw. Ct. 1977), *aff'd*, 412 A.2d 539 (Pa. 1980).

[11] *E.g.*, *State ex rel. Marsh* v. *Nebraska State Bd. of Agriculture*, 350 N.W.2d 535, 540 (Neb. 1984); *State* v. *Elsinore Shore Assocs.*, 592 A.2d 604, 605-07 (N.J. Super. Ct. App. Div. 1991).

[12] *E.g.*, *Arkansas Dep't of Fin. & Admin.* v. *City of N. Little Rock*, 659 S.W.2d 937, 937-38 (Ark. 1983) (utility company deposits); *Cory* v. *Public Utils. Comm'n*, 658 P.2d 749, 751-53 (Cal. 1983) (utility overcharges); *South Carolina Tax Comm'n* v. *York Elec. Coop.*, 270 S.E.2d 626, 627-28 (S.C. 1980) (coop reimbursements); *Presley* v. *City of Memphis*, 769 S.W.2d 221, 224 (Tenn. Ct. App. 1988) (concert tickets).

[13] *Scierstad* v. *Serwold*, 716 P.2d 885, 888-89 (Wash. 1986); *State Dep't of Revenue* v. *Puget Sound Power & Light Co.*, 694

Most states have now amended their laws to conform to the *Texas* rule, and for some states the rule has resulted in a reliable source of revenue. Delaware, for instance, relies on a stream of escheated property currently totalling approximately $20 million annually.

Thus, after the decision in *Texas* v. *New Jersey*, more than twenty states adopted the 1966 revision of the Uniform Disposition of Unclaimed Property Act, 8A Uniform Laws Ann. 135 (1983) (App. A pp. 17a-26a). That uniform act generally allows the state of the owner's last known address to escheat (§ 10); otherwise, it requires persons *holding* unclaimed property to report and deliver it to the state (§§ 11, 13). The more recent 1981 Uniform Unclaimed Property Act (now adopted by twenty-seven states), 8A Uniform Laws Ann. 617 (1983) (App. A pp. 4a-17a) evidences a similar focus on the "holder"—the person indebted to another or in possession of property belonging to another (§ 1(8)). It looks to "the records of the holder" to determine the last-known address (§ 3(1)) and provides that the enacting state takes under the backup rule if "the holder is a domiciliary or a government or governmental subdivision or agency of this State" (§§ 3(3)(ii), 3(4), 3(5)). "Domicile" as to a corporation means "the state of incorporation" (§ 1(6)).

In reliance on the *Texas* rule and these uniform statutes complying with it, forty-four states and the District of Columbia have joined together to participate in the Unclaimed Property Clearing House, a "multi-state cooperative effort to simplify the reporting and collection of abandoned securities and associated cash." Unclaimed Property Clearing House, *Voluntary Compliance Manual* 1 (1991). Of the most populous states, only New York is

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P.2d 7, 12 (Wash. 1985); *State* v. *Liquidating Trustees of Republic Petroleum Co.*, 510 S.W.2d 311, 313-15 (Tex. 1974); *State* v. *New Jersey Nat'l Bank & Trust*, 298 A.2d 65, 66-67 (N.J. 1972); *State ex rel. Mallicoat* v. *Coe*, 460 P.2d 357, 358-59 (Or. 1969); *In re Northeast Utils.*, 479 F. Supp. 194, 198-99 (D. Conn. 1979).

not a member.[14] Each member state signs a form of agreement providing in pertinent part:

> 1. The holdings of the U.S. Supreme Court in *Texas v. New Jersey* (85 S. Ct. 1136) and *Pennsylvania v. New York* (92 S. Ct. 2880) regarding which state has the right to escheat property shall be followed:
>
> (a) Where the name and last known address of the apparent owner according to the books and records of the holder is in [State], it shall be deemed reportable to [State].
>
> (b) If the *holder* has no records whatsoever setting forth the name and last known address of the apparent owner, the property shall be deemed reportable to the *state of incorporation of the holder.*

Clearing House Agreement (Special Consultant's Contract) Ex. 1 ¶ 1 (App. B p. 80a) (emphasis supplied).[15]

This case is about a particular class of intangibles subject to the backup rule of *Texas* v. *New Jersey* and described in paragraph 1(b) of the forty-four-state Clearing House Agreement. The unclaimed intangibles at issue in this case arise because securities are often held by persons other than the beneficial owner, for a variety of reasons described below. *See infra* pp. 13-15 & n.19. In

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[14] Besides New York, the following states were *not* members at the time of the cited publication: Georgia, Hawaii, Maryland, Minnesota, Oklahoma, Rhode Island, South Carolina, and Wyoming. We understand that Hawaii, Minnesota and Oklahoma have since joined, making forty-four state members, plus the District of Columbia.

[15] We do not mean to suggest that their execution of the Special Consultant's Agreement bars the signatory states as a matter of contract from taking their present position. A reservation of rights provision in the Agreement (Ex. 1 ¶ 2, see App. B p. 81a) appears to provide that they are not so barred. But the forty-four states' execution of the Agreement with ¶ 1 in it speaks powerfully as to what the general understanding of the states was as to the meaning of the *Texas* case.

many cases, these holders are listed as holders of record on the issuer's books and receive the property directly from the issuer; in other instances, the holder of the unclaimed property has, instead, received the property from a "depository" that is the holder of record on the issuer's books. (Depositories generally hold securities *only* for the accounts of "participant" brokers and banks. DeCesare Dep. 14-15.) The largest and best-known depository is the Depository Trust Company ("DTC"). In addition to the depositories, the holder entities involved in this case are stockbrokers and banks acting as custodians.

This case concerns only moneys that come into the hands of these holders and are owed by them to persons that they cannot identify, generally because of errors, transfer delays, or imperfections in the systems maintained by the depositories, brokers, and banks.[16] This case, then, does not involve *Texas* v. *New Jersey*'s "primary rule," which governs the property of "lost shareholders" (or bondholders) listed on the books and records of the issuer company—or "lost customers" listed on the books and records of a stockbroker—but no longer in touch with the company or broker. The incidence of these "lost stockholders," "lost bondholders," and "lost customers" and of their escheatable property is apparently very substantial. However, no evidence of its size or relationship to the size of the unclaimed property involved in this case is in the record.[17]

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[16] These amounts were called "overages" or "overs" by some of the witnesses. *E.g.*, DeCesare Dep. 119; Cirrito Dep. 86-87. There was testimony in the record that systemic improvements were in the process of being worked on, which were intended to have the effect of reducing the occurrence of these overages. DeCesare Dep. 79-83; Cirrito Dep. 150-53. To the extent that these systemic revisions are implemented and have the anticipated result, the amounts involved in the subject matter of this case would be reduced in the future.

[17] Such information as exists from publicly-available sources strongly suggests that the universe of securities and distributions escheatable under the primary rule far exceeds that involved in the present case and escheatable under the backup rule. SEC Commis-

Holders such as these, holding stock for beneficial owners or other such holders, serve a number of well-established functions in the securities industry: they allow beneficial owners the privacy that anonymity pro-

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sioner Grundfest, giving comments on an early version of the Delaware takeover legislation being considered in 1988 (*see infra* pp. 63-64), referred to studies indicating that approximately 5% of stockholders never responded to tender offers, regardless of how favorable they were. *Delaware's Proposed Antitakeover Legislation: Hearings Before the House Judiciary Committee of the Delaware State Legislature* 13-14 (Statement of SEC Commissioner Grundfest) (Jan. 20, 1988). Presumably a substantial number of these silent stockholders were "lost"; the issuer no longer was in contact with them, although it had their last-known addresses. Published materials indicate that a search firm devoted to attempting to find lost stockholder estimates that in publicly-held companies, between one-half of one percent and two percent of the stockholders on the companies' records of stockholders' names and addresses are "lost." Thomas Derr, *In Search of Missing Heirs: From Serpico to Senators and Steelworkers*, Focus—Metropolitan Philadelphia's Business Newsweekly, May 14, 1986, at 147 (quoting a spokesperson for Keane Tracers, Inc.).

The total approximate market value of all publicly-held corporate stock actively traded in the United States is $4.367 trillion. Board of Governors of Federal Reserve Sys., *Flow of Funds Accounts, Financial Assets and Liabilities, Fourth Quarter 1991*, at 44 (March 12, 1992) (hereinafter, "*Flow of Funds*"). If one were to take the conservative figure of one percent of the stock being held by "lost" stockholders, the value of their stock would be $43.7 billion. A "haircut" on this number might well be appropriate because one could assume that "lost" stockholders are more likely to be on average smaller stockholders than those who are not lost, and that those stockholders who keep their stock with stockbrokers or bank custodians are, arguably, less likely to become "lost" than those holding it on the company's books. However, even if one assumes a very radical haircut of 80%, a figure of $8.7 billion escheatable under the primary rule is produced. This figure is much in excess of the several hundred million dollars presumed to be involved under the backup rule in this case. *See* New York's Response to First Set of Interrogatories Propounded by Alabama, *et al.* at 5-6 (Answer to Interrogatory 5(d)) (Apr. 27, 1990) (showing annual totals of $40 million to $210 million remitted to New York by DTC, Broker/Dealers and Financial Institutions between 1985 and 1989, with

vides (within certain limitations established by law);[18] they allow beneficial owners to have, and the stock brokerage community to provide, "cash management accounts" in which dividends and interest paid on the customer's securities do not go directly to the customer, but are held by the broker for his account, at interest, usually subject to withdrawal by a check-like negotiable instrument; they facilitate brokerage margin accounts, where the customer's securities are held by the broker as collateral and the dividends and other distributions can reduce the customer's margin debt to the broker; they facilitate the operation of trusts in which the distribution of current income may not be mandatory, but discretionary; they allow for dividend reinvestment programs, where a nominee holds fractional shares purchased with dividends; they allow the efficient transfer of securities by taking certificated securities out of the names and safe deposit boxes of individual investors and putting them in the name and custody of a stockbroker, and, with the growth of depositories, even taking them out of the individual brokers' names and vaults and putting them in the name

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five-year total of approximately $450 million); New York's Response to Delaware's First Interrogatories, Schedule I (March 6, 1989) (showing total of approximately $139 million escheated by New York from Delaware brokerage firms between 1972 and 1988). Moreover, the figures just given for the amount escheatable under the primary rule do not include debt securities, while debt securities are included in the backup rule situation involved in the present case. The total dollar volume of debt securities publicly-traded (excluding U.S. government securities and mortgage pools) in the United States is $2.84 trillion ($1.082 trillion of tax-exempt securities, and $1.758 trillion of corporate and foreign bonds). *Flow of Funds*, at 44. Publicly-traded mortgage pools are another $1.168 trillion. *Id.* at 46.

[18] For example, when a beneficial owner or group of beneficial owners beneficially owns more than 5% of a class of equity securities of an SEC-registered company, it or they must file a "Schedule 13D" disclosure statement. Securities Exchange Act § 13(d), 15 U.S.C. § 78m(d); *see also* Securities Exchange Act § 16(a), 15 U.S.C. § 78p(a) (directors, officers and 10% stockholders).

of the depository, where they can be transferred to other depository participants simply by entry on the depository's books.[19]

This last function has now largely been fulfilled by DTC, which "immobilizes" securities certificates. DTC was created by securities brokers and dealers, stock exchanges and banks in order to "immobilize" certificates, so as to alleviate the paperwork crisis that had developed as a result of the physical deliveries of certificates in connection with trading. DTC Statement (filed with the Master March 16, 1990, and marked as DTC Ex. 13) at 1; DeCesare Dep. 377. In responding to that crisis, the interindustry committee responsible for the creation of DTC considered and rejected a proposal that would have made the depository a "*transfer agent* for the issuer." DTC Statement 3 (emphasis by DTC). DTC has no contractual relationship with issuers, except in cases of DTC "book-entry-only" securities, which do not give rise to abandoned property under the backup rule. *Id.* at 4 n.*.[20]

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[19] *See generally* J. Robert Brown, Jr., *The Shareholder Communication Rules & the SEC*, 13 J. Corp. L. 683, 687-93, 695 n.59 (1988) (discussing advantages of nominee ownership); Egon Guttman, *Modern Securities Transfers* ¶ 4.04[1][d][i] at 4-16 to 4-17 (1987) (discussing use of street name to facilitate transfer of securities); Ira L. Sorkin & Carman J. Lawrence, *An Overview of Stock Loan/Stock Borrowing*, 501 PLI/Corp. 275, 279 (1985) (role of DTC in pledging securities); 7 William D. Hawkland, *et al.*, *UCC Series* § 8-303:02 at 210 (1990) (use of securities as collateral in margin accounts); Simon M. Lorne, *Acquisitions & Mergers: Negotiated & Contested Transactions*, § 3.09[2][b] at 3-56 to 3-57 (1989) (same); Richard S. Rothberg, *Registration of Fiduciary Securities in 'Street Name': a Look at EPTL § 11-1.10*, 57 N.Y. St. B.J. 34, 35 (1985) (benefits of street name registration for fiduciary and trust accounts); DeCesare Dep. 202 (dividend reinvestment plans must allow for nominee participation), 377 (depository system facilitates transfer of securities), 430-32 (depository facilitates pledging of securities); Wellener Dep. 36-37 (dividend reinvestment plans).

[20] Even in this situation, DTC is the holder of record of the entire issue, but does not purport to act as agent for the issuer.

[Footnote continued]

DTC's "core service" is to provide for "the efficient settlement of securities transactions with physical certificates immobilized in a central location." *Id.* at 6-7. The immobilization requires DTC to provide what it considers "ancillary services," as well—including the "collection and payment of dividend and interest distributions." *Id.* at 7.

The practice by stockbrokers, bank trust departments and custodians, and, lately, depositories, of holding securities in their own names rather than the beneficial owners holding them in theirs, is sometimes called holding securities in "street name" or in "nominee name." [21] These intermediate holders serve numerous functions and their role in the securities industry predates even the first federal securities legislation.[22] One function they do not serve well, however, is the efficient distribution of dividends, interest and other distributions. Obviously, in terms of pure efficiency in getting the moneys from the issuer to the beneficial owners, it would be best if all the beneficial owners appeared on the issuer's record.

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[20] [Continued]

DeCesare Dep. 156 ("we hold 100 percent of what's outstanding in a single certificate"), 209-10 (statement of DTC's counsel that DTC holds a certificate as recordholder under U.C.C.).

[21] While the stockbrokers, bank custodians and depositories are sometimes called "nominees," strictly speaking, "nominee" refers to an entity, generally a partnership composed of officers of the bank or depository, which adopts a short name and holds securities for the account of the depository, bank trust department or other holder, in order to avoid, through the use of a partnership name, the onerous stock transfer requirements that may attend transfers by a corporation and particularly by a corporate fiduciary. Probably the best known nominee in this sense is the nominee of the DTC, "Cede & Co."

[22] *See Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *North Eur. Oil Royalty Trust*, 490 A.2d 558 (Del. 1985); S. Rep. No. 1455, 73d Cong., 2d Sess. 76 (1934); *Final Report of the SEC on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities* (Dec. 3, 1976) (hereinafter "*SEC Street Name Study*") at 1-3.

DeCesare Dep. 405-07. But for the various reasons just outlined, they do not. Moreover, in many situations—as, for example, margin accounts that are not fully collateralized, margin accounts with sweep features but negative cash balances (Principe Dep. 53), or certain trust accounts—there may be an intent *not* to distribute cash dividends to the beneficial owner of the underlying security.

By 1965, when the Court decided *Texas* v. *New Jersey*, 23.7 percent of the equity securities of publicly-owned companies was held in nominee and street name. *SEC Street Name Study* 78. By 1975, shortly after the Court decided *Pennsylvania* v. *New York*, the proportion had risen to 28.6 percent. *Id.* The trend toward securities certificate immobilization has continued. During the 1980s, it passed the 50 percent mark.[23]

As these figures indicate, the practice of "street name" or "nominee" registration is far from universal. Many investors, large and small, prefer to be stockholders of record. There are only a handful of depositories and probably no more than a few thousand stockbrokers and bank trust departments/custodians actively engaged in holding securities for the accounts of participants or customers. Yet annual SEC filings for 1991 indicate that, for example, American Telephone & Telegraph Company had 2,426,354 common stockholders of record; General Motors had 1,774,420 stockholders of record of its various classes of common stock; General Electric had 490,000 common stockholders of record; IBM had 772,047 common stockholders of record; and BellSouth had 1,355,908 stockholders of record.[24] Thus the vast majority in number of their recordholders were also beneficial owners.

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[23] Division of Market Regulation, SEC, *Progress & Prospects: Depository Immobilization of Securities & Use of Book-Entry Systems* 4 (June 14, 1985).

[24] AT&T 1991 Annual Report to Stockholders, inside back cover; GM 1991 10-K Report, p. II-45; GE 1991 10-K Report, pp. 21-22;

New York's practice with respect to all unclaimed stock and distributions held by these intermediate holders has been particularly aggressive. New York does not participate in the cooperative efforts of the Unclaimed Property Clearing House. It has an overbroad statute, calling for the delivery to New York of all abandoned securities held by brokers doing business in New York—without regard to whether the holder's records indicate that the owner's last known address is in New York, or (if there is no known owner or address) whether the broker is incorporated in New York.[25] To make matters worse, New York's three-year dormancy period is the shortest in the nation. *See* Egon Guttman, *Modern Securities Transfers* at S16-2 to S16-32 (3d ed. Cum. Supp. 1991).[26] New York's aggressiveness—and the reliance of other states on the *Texas* rule—is illustrated by a letter on the letterhead of Texas' then Treasurer (now Governor), Ann Richards, to E.F. Hutton, a brokerage firm that did business in New York (but was incorporated in Delaware). Ms. Richards' representative wrote to express her department's frustration with the broker's practice of submitting *all* unclaimed intangibles to New York: "the rule adopted [in *Texas* v. *New Jersey*] requires reporting to the state of last-known address of the creditor (or owner) as shown by the debtor's (holder's) books and records; and if there is no last-known address, then to the state of incorporation of the debtor." [27]

IBM 1991 Annual Report to Stockholders, p. 53; BellSouth 1991 Annual Report to Stockholders, p. 62.

[25] N.Y. Abandoned Property Law § 511 (McKinney 1991) (App. A pp. 38a-48a). New York has not amended its statute to comport with the requirements of *Texas* v. *New Jersey*.

[26] Some other states also have a three-year period. *See, e.g.*, Cal. Civ. Proc. Code § 1513 (West Supp. 1992).

[27] Letter of October 16, 1986 (Appended to N.Y. Supp. Reply Br. (Nov. 20, 1991)) (App. C hereto at p. 82a). Unlike its current position, Texas there made no suggestion that E.F. Hutton should be

New York takes possession of unclaimed "owner/address unknown" cash and other intangibles held by DTC (a New York banking corporation) without question from Delaware; the same is true with such property held by New York banks. But a large number of brokerage houses are incorporated in Delaware.

Delaware therefore commenced this action in this Court to collect the "owner/address unknown" funds that were taken by New York from "Delaware Brokerage Corporations." Delaware's suit was a narrowly drawn one, entirely dependent on the application of the settled rules of this Court's prior decisions to the facts of what New York was doing. Because the exclusive forum for suits between states is this Court, Delaware's case, although having elements of a "collection" suit, had to be brought here; indeed, New York, urging that the case did not involve substantial questions of law but only factual issues, contended that this Court should exercise its discretion not to hear it. Brief of N.Y. in Opp. to Motion for Leave to File Complaint 24 (May 9, 1988). New York's substantive position was that the property in question, which appears to be "owner/address unknown," actually is not; New York claims that all the unknown owners whose funds are held by stockbrokers may be "statistically" presumed themselves to be stockbrokers, with "trading addresses" in New York. *See* Report 58-59 & n.50.

Early on, Delaware found allies in several states who appeared as *amici curiae* in its support and asserted that "New York is not entitled to escheat unclaimed intangible property held by brokers conducting business in New York but incorporated elsewhere."[28] They expressed a "sig-

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looking to the state of principal executive office of each issuer of owner unknown property, or that the *issuer* was somehow the "debtor." On the contrary, the "holder" is described by Texas as the "debtor." The debtor's domicile was its "state of incorporation."

[28] Brief of *Amici Curiae* Pennsylvania, Florida, Rhode Island, New Jersey, Arizona, Utah, and Arkansas (May 9, 1988) at 2.

nificant interest in this matter because they rely upon the rules of priority established by the Court . . . . Adherence to these equitable standards enables *amici* States to avoid litigation resulting from inconsistent claims to the same property. The relief sought by Delaware is compatible with the rules followed by *amici* States." *Id.* Again, *amici* reiterated: "[i]f no record is available, or if the state with priority had no escheat law, then the state of the *holder's* incorporation [is] entitled to escheat the property." *Id.* at 5, 9 (emphasis supplied).

4. *Reference to the Master.*—After granting Delaware's motion to file its complaint, the Court appointed a Special Master. 488 U.S. 990 (1988). There followed massive interventions in what resembled a feeding frenzy. Delaware's early *amici*, who had viewed Delaware's position as consistent with the "salutary holding of *Texas* v. *New Jersey*" (Brief of *Amici* at 10), came to see an opportunity to modify the rules and collect a windfall. Starting in 1989, they sought intervention, as did every state in the Union (and the District of Columbia),[29] advocating one or another theory that would allow them to recover the money at issue under the backup rule.[30] Unclaimed intangibles held by DTC and the New York bank nominees were added to the scope of the case when the Court granted Texas' motion to intervene, greatly increasing the case's scope.[31]

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[29] The last of these applications to intervene, that of Massachusetts, came only in March 1992, two months after the Master's Report.

[30] The Court has not passed on any of the applications for intervention other than that of Texas, but the Master has favorably recommended all of the motions to intervene that he received prior to January 28, 1992 (Report 5), and the states seeking leave to intervene have been permitted to participate before the Master as fully as if this Court had approved their intervention.

[31] In comparison to the roughly $450 million remitted by DTC, Broker/Dealers and Financial Institutions during the period 1985 to 1989, New York received only $139 million of funds remitted

Two new theories emerged. A group led by Texas urged a modification of the rule previously called "salutary"—they argued that the state of incorporation of the *issuer* should be entitled to escheat the unclaimed funds, rather than the state of incorporation of the *holder* (as per the Texas letter, the practice of forty-five jurisdictions through the Unclaimed Property Clearinghouse, and the brief for the seven early *amici* states). This, although the funds were no longer held by the issuer (who indeed had no claim whatsoever to them). Among the Texas group are former *amici* Florida, New Jersey, Pennsylvania, Utah, Arkansas, and Arizona.

A group with a more radical agenda was led by California. This group's theory called for an outright overruling (at least in the present situation) of the backup rule, and its replacement with a test to be determined by the states in a process of negotiation or binding arbitration once the Court overruled *Texas* v. *New Jersey*. That test has not been articulated with any precision by this group but it seems to be related to the incidence of investor activities throughout the United States. Among this group is former *amicus* Rhode Island.

Various motions for judgment on the pleadings and for partial summary judgment were filed. The Master allowed limited discovery, only on the subject of how

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from *Delaware* Brokerage Firms for a much longer time period (1972 to 1988). *See supra* pp. 13-14 n.17. Because the DTC and the New York banks were New York-domiciled, Delaware's complaint did not seek "owner/address unknown" property in their hands (or in the hands of brokers not incorporated in Delaware). By seeking a revision or reinterpretation of the *Texas* v. *New Jersey* "backup" rule to refer to the corporate domicile of the "issuer" of the securities on which the distributions had been paid, rather than the holders who owed them to an unknown creditor, the Intervenors attempted to get a share of the larger pie ($450 million), which includes that held by the Delaware brokerage firms that were the original object of the suit. (The figures for the "larger pie" may be swollen by New York's proper or improper escheats of dormant broker customer accounts, for which of course there are names and addresses. *See* Principe Dep. 110.)

the present nominee dividend and interest distribution system works; he permitted no discovery on any other matter, such as the consequences of changing or reinterpreting the escheat rules.[32]

5. *The Master's Report and Recommendation.*—The Master's Report recommends two changes to the *Texas* rule—one acknowledged, the other not. *First*, the Report recommends that the terms "debtor" and "creditor" used in *Texas* v. *New Jersey* and *Pennsylvania* v. *New York* should be viewed merely "as an attempt to identify the relevant parties" rather than as a description of legal relationships. The Report purports to have discovered a federal common law definition of the term "debtor" that bears no relation whatever to the state property laws giving rise to the unclaimed property in this case. Under this federal common law, the state laws that govern the establishment of and rights—both private and public—in the property at issue are to be ignored; instead, according to the Report, the "relevant attributes" of the parties to each type of transaction must be evaluated in order to determine which ones are *most like* the parties in *Texas* v. *New Jersey* and *Pennsylvania* v. *New York*. The Report goes on to conclude that the task is impossible in this case. Report 32-34. Therefore the Report resorts to a "tie-breaker" by intuiting which interpretation would be more "fair." Report 35. Under this approach—which ignores the ordinary meaning of the words debtor and creditor—the Report concludes that the *issuer*, rather than the *holder*, should be viewed as the "debtor."

Second, the Report recommends that the Court abandon the part of the backup rule that views the state of incorporation of a corporate "debtor" as its "domicile" and thus entitled to escheat; instead, the Report recommends that the state of the "principal executive office" of

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[32] Indeed, the Master denied an application by Delaware, following the Master's exposure of a draft report reaching substantially the same conclusions that his Final Report did, that discovery be permitted before the Master's Report was made final. Discovery Order No. 15 (Jan. 28, 1992).

the corporate "debtor" (of course, as redefined) should be entitled to escheat. This modification was proposed by the Master *sua sponte*—no one (not even the California group) suggested that the backup rule thus be modified until after the Master circulated a draft of his Report containing such a recommendation for comment. The Report contains no definition of how far this recommendation applies. Is it just for this case? Or is it supposed to operate as an overall replacement for the "state of incorporation" in the backup rule of *Texas* v. *New Jersey?* Other than (1) what may be gleaned from a somewhat cryptic footnote in the Report (p. 35 n.32) suggesting that the abandonment of the "state of incorporation" rule would assist in making the "debtor is the issuer" rule "fair" and (2) the Report's discussion of the pertinence of securities issuers' SEC reports (Report 44-48),[33] no limiting principle is apparent in the Report.

The Report did not undertake to say what its recommendation was as to who should prevail between the plaintiff Delaware and the defendant New York if the Master's recommendation about the "issuer as debtor" theory of the Texas Intervenors and his spontaneous substitution of "principal executive office" for "state of incorporation" were not accepted by the Court. However, the Master's discussion of New York's arguments concerning the backup rule (Report 67-68) clearly indicated that Delaware was to prevail in such case.

SUMMARY OF ARGUMENT

I. Neither of the two rule changes recommended in the Report, one acknowledged as a change by the Master and the other not, should be adopted.

A. 1. Contrary to the Master's conclusion, there is no reason to believe that this Court used the word "debtor"

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[33] But looking the other way, see the Draft Report's consciousness that the new rule might be applied "in other cases (or circumstances)." Draft Report 57 n.64, quoted in our Exceptions at E-8.

in the *Texas* and *Pennsylvania* cases in other than its usual and conventional meaning—one who owes something to another. The Master's construction, indeed, requires one to assume that the Court used that word in two different senses on the same pages in those decisions. Under the law of all 50 states, the "issuer" of securities is not a debtor of anyone with respect to a dividend or interest distribution once the issuer has paid it to the security holders shown on its record. Construing "debtor" to mean what state law considers to be a debtor is rooted in the tradition of escheat cases prior to the *Texas* case; the Master's recommendation goes beyond the traditional limits of substantive due process taught by those earlier decisions. *In personam* jurisdiction due process questions join to suggest that the Master's recommendation is so extraordinary as to be suspect.

2. Under state law, the issuer is not a "creditor" of the nominee holder, nor a debtor of the beneficial owner; and the record establishes that the nominee holders are not agents of the issuer. The Uniform Commercial Code in all 50 states and state corporation law confirm that the issuer discharges its indebtedness with respect to a distribution by properly paying the holder of record. Commercial practice also confirms this. The reasons given by the Master and the Intervenors for ignoring these uniform rules are without merit. The Master's approach is metaphoric rather than legal and the Intervenors cite either state statutes that provide options which issuers never use or SEC rules that are inapplicable to dividends and do not mean what the Intervenors contend.

3. The Master's recommendation on this score is in essence that the state law as to who is a debtor should be ignored. But in this case, the federal law with respect to the permissibility of escheat necessarily builds on state law. It is property created by state law that is the subject of escheat. There is no federal reason to displace state law in this situation. It would compound the error

not only to displace state law, but to displace state law which happens to be uniform in all 50 states.

4. The Master's suggestion that "fairness" demands that the money in question be "sent back where it came from," to the issuer, as a sort of "tie-breaker," is based on the Master's personal notions of fairness which hardly seem necessary ones; the "send it back where it came from" rule has been rejected by this Court before, and making a rule change purely for the sake of alleged "fairness," in the terms conceived by the Master, appears to be a choice for the legislative branch.

B. The Master's *sua sponte* change in the definition of corporate domicile from "state of incorporation" to "state of principal executive office" is likewise unjustified.

1. No developments in the law since 1965 indicate that the choice made by the Court in the *Texas* case and reaffirmed in the *Pennsylvania* case should be abandoned. This Court has, indeed, in the intervening period, repeatedly stressed the important role of the incorporating state in corporate matters.

2. The present rule works well administratively. The replacement rule suggested by the Master is unworkable and will be a source of litigation and conflict; even the provisions of the U.C.C. that the Master finds establish workability demonstrate exactly the contrary. Moreover, even the prop the Master has suggested be used—the principal executive office address given in SEC filings —is unavailing if the rule is applied beyond the narrow context of the present case and to the extent of the backup rule generally, since it will involve corporations that are not SEC filers. The Master suggests no limiting principles why the rule change as to the determination of corporate domicile should be limited to the specific situations involved in this case.

3. Fairness demands retention, not rejection, of the present rule as to corporate domicile. A properly chosen

state of incorporation can provide significant benefits to shareholders, as recent academic analyses and studies indicate. Given recent developments in real-world corporate sociology, the same cannot be said with any confidence as to the state of "principal executive office." The location of principal executive offices has over the decades ceased to have any relevance to the productive activities of corporations and has become more and more a personal choice by a small cadre of top corporate executives.

4. Here again, the Master's notions of "fairness" are misconceived. The Master also ignores the public-sector efforts that a state, like Delaware, must make in order to provide its corporations with a properly functioning statute and a judiciary attuned to sophisticated issues of corporate law; it would be unfair to disregard those efforts.

C. Both with respect to the corporate domicile rule change and as to his recommendation that the issuer is to be considered the "debtor," the Master ignores the principles of *stare decisis* that have been taught by the decisions of this Court, and violates the expectations of the states expressed by their adoption of the uniform escheat acts.

II. Should the Court, contrary to our contentions, accept one or both of the Master's recommendations for rule changes, the ruling should not be made retroactive as the Master suggests. Retroactivity would cause the states that relied on the plain language of the *Texas* and *Pennsylvania* cases and adopted the uniform acts implementing them to be divested of property escheated in reliance on them. The very purpose of the *Texas* rule was to have a clear, certain and simple rule "once and for all" to resolve conflicting state claims for escheat. Retroactivity here would disturb Delaware's justifiable reliance on the rules laid down in the *Texas* case and would be inconsistent with this Court's precedents concerning retroactive application of changes in judge-made

legal rules, particularly in the context of asserting retroactivity against a state.

III. The Master rejected New York's theories underlying its factual assertions about the moneys originally at issue in this case. New York's contention that the moneys in the hands of brokers owed to persons unknown should, on a statistical basis, be deemed to be owed generically to "other brokers," and that all those other brokers should be deemed to have "trading addresses" in New York, was rejected by the Master, and properly so. The record amply confirms the Master's findings on this point.

But because the Master proceeded on his theory of "the issuer as debtor" and on his rule change concerning the test of corporate domicile, the Master never drew the conclusions that necessarily would flow from those findings, should this Court not follow his recommendations that the "issuer" was the "debtor" and that the corporate domicile rule should be changed. However, it follows necessarily from the Master's correct findings about New York's theory that Delaware should have judgment against New York, and this Court should so rule.

ARGUMENT

I. THE COURT SHOULD ACCEPT NEITHER THE MASTER'S UNACKNOWLEDGED CHANGE TO THE BACKUP RULE—THAT "ISSUER" BE SUBSTITUTED FOR "DEBTOR"—NOR HIS ACKNOWLEDGED CHANGE—THAT "STATE OF PRINCIPAL EXECUTIVE OFFICE" BE SUBSTITUTED FOR "STATE OF INCORPORATION"

The Master's Report, if followed by this Court, would destroy the stability that the Court's earlier decisions have brought into this field and would unsettle the law in an area where litigation involves the exclusive original jurisdiction of this Court. The Master proposed two

rule changes: the first rule change, not acknowledged as such, applies a theory of "federal common law" to set aside the definition of who is a debtor under the laws of all 50 states. The second overrules a prescription of corporate domicile for escheat purposes followed in the two original cases and having its roots in the prior escheat jurisprudence. The alternative rule proposed is arbitrary, amounts to change for change's sake, and particularly if applied beyond the scope of this case—as well it may, since it is without limiting principle—will be the source of great administrative difficulties. Following the Master's recommendation would involve a departure from this Court's decisions on the proper application of the rules of *stare decisis*. The Master's notions of "fairness," which prompted the rule changes, seem hardly persuasive; but if they are, presumably the matter of changing the rules can be left to the attention of Congress.

A. In the Circumstances Involved in This Case, the "Issuer" Is Not a "Debtor" with Respect to the Dividends and Interest Under State Law, and Should Not Be Regarded as a "Debtor" by This Court for Purposes of Escheat

Following a circuitous path, the Report accepts the position of the Texas group and recommends that the "issuer" (rather than the holder of the unclaimed property) be deemed the "debtor" under the *Texas* rule. The Report begins with a fundamental misapprehension about the nominee system: that it was designed for the purpose of speeding the *distribution of dividends* and therefore "the distribution system's use of intermediaries may have originated as a matter of convenience." Report 25. There is absolutely no evidence in the record, and no party contended, that nominee holders exist in the chain of title between the issuer and the ultimate beneficial owners of securities for the purpose of "convenience" in getting dividends into the hands of the beneficial owners. As we explained above (*see supra* pp. 13-15 & n.19), the nominee

system was designed to perform a number of functions *other* than the distribution of dividends; efficient distribution of dividends is accomplished largely *in spite of* the presence of nominee holders.

The Report then appears simultaneously (1) to reject the relevance of state law to the determination of the identity of the "debtor" and (2) to suggest that under state law the recordholders may not be debtors of the persons for which they are nominees (suggesting that possibly the issuer is). This latter suggestion appears to proceed from a misconception that the recordholders do not consider themselves as possessing an "asset" in the form of the moneys in turn owed to the unknown creditor. Report 25-26.

This statement is controverted by the record and other evidence. It is clear that the cash in the hands of the recordholders is viewed as an asset and that there is a corresponding liability. *See* American Institute of CPAs, *Audits of Brokers & Dealers in Securities* 34-36 (1973) (listing "Failed to Deliver" accounts and customer accounts as assets, with corresponding liability for "unclaimed dividends") (Lodged with the Clerk by New York (May 9, 1988), Tab C); Cirrito Dep. 84. The DTC uses the excess cash from the "overages" in its hands at issue in this case to pay its expenses in attempting to find the creditors and distributes the surplus annually to its participants. DeCesare Dep. 152-53, 317, 475. The brokerage houses are free to use these funds in their business, subject only to certain limitations, not applied on an individual basis, similar to those applicable to any customer's funds in a broker's hands. *See infra* pp. 44-45 & n.57. Subject to those limitations, the brokers and banks put the moneys in their general bank accounts; in whatever account, they appear to earn and retain the interest on these funds. Shearer Dep. 261-65; Wellener Dep. 66; Cirrito Dep. 95-96. If the funds are unclaimed during the statutory waiting period and

are escheated to New York, no interest is due New York if the funds are remitted promptly. N.Y. Abandoned Prop. L. § 511.2. All of the witnesses testified that their firms escheated the "overages" to New York. Cirrito Dep. 93; DeCesare Dep. 152; Principe Dep. 109; Scott Dep. 175; Shearer Dep. 185-86; Wellener Dep. 59-61. Thus, any interest earned during the waiting period inured to the benefit of the holder.[34]

These fairly obvious factual errors in the Report are then compounded by its failure to give the words used in the *Texas* rule their ordinary meaning; the Report instead concludes that the Court's use of the terms "debtor" and "creditor" was "descriptive—an attempt to identify the relevant parties."[35] The Report therefore concludes that

[34] The Report also exhibits a confusion between assets and net worth. It is claimed that the intermediaries do not possess an asset "that would properly be reflected on a balance sheet in the sense of being a positive factor in establishing the intermediary's corporate worth." Report 26. But an asset is no less an asset because its acquisition is accompanied by a countervailing liability and does not increase net worth. The existence of a countervailing liability does not mean that the asset is not an asset. If one deposits $100 in cash in a bank, the bank's cash assets increase by $100 and its deposit liabilities increase by the same amount, so that there is no increase in its net worth. But after the deposit the cash is an asset of the bank, and conducting such matching transactions is a principal part of a bank's business.

[35] Report 29. This reasoning is peculiar. Clarity in identifying the relevant parties is promoted by using their actual names—"Sun Oil"; "Western Union," etc. (*see* Fed. R. App. P. 28(d)); words describing the parties' legal relationships tend to be more useful in setting down generally applicable rules, so that those who must apply the rules need not search for other relevant attributes. Indeed, in *Texas* v. *New Jersey*, the Court described the parties in just that way—identifying them by name until it came time to evaluate the four "different possible rules" to be applied to "intangible property, such as a debt," 379 U.S. at 677-78, at which point the Court switched from the parties' names to the general words "debtor," "creditor," and "state." In stating the generally applicable rule, the Court used the words that described the parties' legal relationships—not their "relevant attributes"; unless one views the "relevant attributes" as that of being a "debtor" and a "creditor."

the Court did not intend the words to have their ordinary meanings, but instead "intended . . . to ask future courts (and Special Masters) to search for parties with relevant *attributes* . . . of the parties denominated 'creditors' and 'debtors' in these two opinions." Report 30 (emphasis in original). By declining to give the word "debtor" its ordinary meaning, the Report creates an unnecessary ambiguity; it then asserts that the ambiguity may only be resolved with resort to a so-called "tie-breaker"; and it concludes by intuiting which interpretation of the word would be more "fair." Report 35.

This approach suffers from a number of flaws. First, and most simply, it violates the letter and spirit of the *Texas* rule and the fundamental legal principles that gave rise to it. Second, it improperly ignores state law. Finally, the various technical justifications given by the Master and others for this departure from precedent are unavailing.

1. *The "Issuer as Debtor" Recommendation Violates the Rule of* Texas v. New Jersey *and Contravenes the Legal Underpinnings of the Doctrine of Escheat*

(a) *Texas* v. *New Jersey* demands two elements: a known "debtor," who owes the money or property; and a "creditor"—who is either "known" but "lost" (under the primary rule) or "unknown" (under the backup rule)—to whom the debtor owes the money or property but cannot pay it. The backup rule provides a simple, clear, black-letter rule for governments and businesses to live by: "if [the creditor's last known] address does not appear on the debtor's books or is in a State that does not provide for escheat of intangibles, then the State of the debtor's incorporation may take custody of the funds." *Pennsylvania* v. *New York*, 407 U.S. at 210. Based on this clear, black-letter rule, 45 jurisdictions have joined together in the Unclaimed Property Clearing House, with an agreement interpreting "debtor" as "holder" in the

context of the backup rule, and have organized computer programs and other systems to carry the rule into practice.

The Report makes a simple inquiry complicated. Rather than looking to the current debtor, the Report "interprets" the rule by purporting to discover that the "debtor" under the *Texas* rule actually means "*former* debtor." But the usual definition of a "debtor," in both ordinary and legal usage, is someone who—in the present tense—owes something to another. *See* Webster's Third New International Dictionary 583 (1986) (defining "debtor" as "one owing money to another"); Black's Law Dictionary 404 (6th ed. 1990) (defining "debtor" as "[o]ne who owes a debt to another who is called the creditor; one who may be compelled to pay a claim or demand; anyone liable on a claim, whether due or to become due," and quoting the definition in U.C.C. § 9-105(1)(d), "the person who owes payment or other performance").

The holders in this case meet the usual definition of a "debtor"—they owe the distribution in their hands to the creditor, whose identity is not known. It is not surprising that the widely adopted uniform acts recognize that the "holder" of the unclaimed property (the one with the obligation to hand it over to the escheating state) is the "debtor" under the *Texas* rule. *See supra* p. 10. Indeed, the official commentary to Section 3 of the 1981 Uniform Act states that in *Texas* v. *New Jersey* "[t]he Supreme Court ruled that, when property is owed to persons for whom there are no addresses, the property will be subject to escheat by the state of the holder's domicile." 8A Uniform Laws Ann. 634 (1983). And all agree that under relevant state commercial and corporation law and practice (adopted and recognized by all 50 states and the District of Columbia), the issuer is neither a "creditor" nor a "debtor" at the time of escheat regarding the dividends and interest that, as here, have found their way into the hands of a recordholder (or a participant in a depository recordholder): once an issuer has made a

distribution to the recordholder of the security, the *issuer* no longer has any right or interest at all in the distribution; and having discharged its obligation by paying the recordholder, it is certainly not a "debtor." *See infra* pp. 37-39.

The Report's recommendation actually requires the word "debtor" to carry different meanings for purposes of the primary and backup rules in the context of the situation involved in this case. To implement the primary rule, which is that property is subject to escheat "only by the State of the last known address of the creditor, as shown by the debtor's books and records," *Texas* v. *New Jersey*, 379 U.S. at 682,[36] one must look to the "holder's" books and records for a lost creditor with a last-known address. The person to whom the *holder* may be owing the funds would not be shown by the *issuer's* books and records; the issuer's records in these situations would show only a depository, broker or bank which has been paid. But once it is determined that the "primary rule debtor" (here, the holder) shows *no* last-known address for the creditor, the Master then stops viewing the holder as "debtor" and the issuer then becomes the "debtor" for the purposes of determining the application of the backup rule. Thus, one must read the *Texas* and *Pennsylvania* cases as using the word "debtor" in different senses in the same opinion[37] or in the same paragraph,[38] if one follows the Master.

(b) The *Texas* rule was not drawn out of thin air. It was the culmination of a long line of cases defining the limits of a state's power to escheat. *See supra* pp. 2-6. By failing to consider these cases, the Report's recommendation exceeds those limits.

In his call for a "lawyerlike definition of state power over this subject," Justice Jackson summarized "[t]he

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[36] For almost identical language, see *Pennsylvania* v. *New York*, 407 U.S. at 210.

[37] *Texas* v. *New Jersey*, 379 U.S. at 677, 679, 681.

[38] *Pennsylvania* v. *New York*, 407 U.S. at 210.

two usual examples of escheat [that are] properly incidents of sovereignty":

> First, sovereignty in the sense of actual dominion over the property escheated. . . . The right to appropriate intangible property constructively within the state . . . has been upheld by this Court . . . . Second, sovereignty over the person, as a resident or citizen, will justify the state in stepping into his shoes as claimant of abandoned property.

Connecticut Mut. Life Ins. Co. v. *Moore*, 333 U.S. at 560-61 (Jackson, J., dissenting).[39]

Justice Jackson thus synthesized the two sources of a state's power to escheat: power to step into its citizen's shoes as a claimant, and power to seize funds from a person subject to its jurisdiction. The *Texas* rule does not supplant these principles; it builds on them, providing a framework for the states to exercise their escheat power within the limits imposed by their status in our federal system as coequal sovereigns and by the Due Process Clause. The primary rule allows the last known sovereign to step into the creditor's shoes and claim the funds for her. The backup rule allows the state where the intangible property is constructively located to claim it if no appropriate sovereign can be identified under the primary rule.

Under the Report's recommendation, however, neither the primary rule's state—which steps into the shoes of the *creditor*—nor the backup rule's state—which exercises constructive dominion over the *debt*—is allowed to escheat. Instead, a third state—with no relationship whatever to the holder of the funds or to the lost claim-

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[39] For background, see Note, *Origins and Development of Modern Escheat*, 61 Colum. L. Rev. 1319, 1319-23 (1961); Ray H. Garrison, *Escheats, Abandoned Property Acts, and Their Revenue Aspects*, 35 Ky. L.J. 302, 302-04 (1947); *Anderson Nat'l Bank* v. *Luckett*, 321 U.S. at 240; *Late Corp. of the Church* v. *United States*, 136 U.S. at 56-57.

ant—has priority. Thus, as long as the rule under state law is that the issuer is not a "debtor," it would appear to go beyond the traditional limits of the Due Process Clause to permit the state in which the issuer is located, but where the state-law debtor is not, to escheat in an "owner/address unknown" situation. Where a state, under its own laws, is not a place where the "debt" (that is, the "debtor") is located, or a state where the creditor (as per her last-known address) is located (since the identity of the creditor or her address is unknown) there might be no connection at all between the escheating state and the holder of the funds.[40] To be sure, the states might amend their corporation laws to provide that payment by an issuer to the record owners does *not* discharge the issuer's obligations, and the due process limitations thus might be overcome (assuming that the corporate domicile rule remains intact); but that is not the law today, and surely the disastrous effect of such a rule on corporations and municipal issuers would dissuade most legislatures from adopting it. Accordingly, serious substantive due process concerns are implicit in the Master's recommendation on this score—concerns that appear insurmountable if both rule changes are adopted.

In personam jurisdictional due process issues also suggest that the rule recommended by the Master is so extraordinary as to be suspect. Under the Report's recommendation, a state making claim to the property at issue might have no contacts whatever with the holder.

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[40] *National Geographic Soc'y* v. *California Bd. of Equalization*, 430 U.S. 551, 554 (1977) (Due Process Clause requires some "nexus" between out of state seller of goods and state imposing sales and use taxes); *National Bellas Hess* v. *Department of Revenue*, 386 U.S. 753, 756 (1967) ("'some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax'") (quoting *Miller Bros.* v. *Maryland*, 347 U.S. 340, 344-45 (1954)); *State Bd. of Ins.* v. *Todd Shipyards*, 370 U.S. 451, 455 (1962) (Due Process Clause precluded Texas' taxation of insurance premiums where "only connection between Texas and the insurance transaction is the fact that the property covered by the insurance is physically located in Texas").

In such a situation, the Master conceded that the holder would be protected from being sued in the courts of the state claiming the right to escheat under *International Shoe Co.* v. *Washington*, 326 U.S. 310 (1945), and *Shaffer* v. *Heitner*, 433 U.S. 186 (1977).[41] The Report, however, observes that "nothing in those [recommended] rules would prohibit the state of incorporation from suing in the courts of the state where the unclaimed property was located." Report 69.

That response reveals just how dramatically this proposal would cut the doctrine of escheat away from its roots and impair the ability of states to enforce their escheat laws. Creating a regime in which states were required to resort to the courts of sister states would be an unseemly derogation from the independence afforded to coordinate sovereigns in our federal system. *See Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493, 500 (1971) ("no State should be compelled to resort to the tribunals of other States for redress, since parochial factors might often lead to the appearance, if not reality, of partiality"). It would also unduly burden escheat collection. It is no answer to say that—*with permission*—a state might be able to collect escheatables in a sister state's courts.[42] In order to ensure compliance with their escheat

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[41] Report 69; *see also* Report of John F. Davis, Special Master, *Pennsylvania* v. *New York* (November 1971) at 18-19 (confronting the "serious question as to the legality of cutting off or impairing an individual's property rights by an *in rem* proceeding" in a "forum having no continuing relationship to any of the parties to the proceeding"). The Court did not need to resolve the Master's "doubts as to the constitutionality of the alternative formulas for escheat" (*id.* at 20) because it was presented with no good reason to "carv[e] out an exception to the *Texas* rule." 407 U.S. at 214.

[42] We may pass over, for these purposes, whether states would be *required* to open their courts to the enforcement authorities of sister states. *See* Restatement (Second) of Conflict of Laws § 89(b) & Reporter's Note, Taxes (1967) ("it is an 'open question' whether a State is under constitutional compulsion to enforce the revenue laws of a sister State") (citing *Milwaukee County* v. *M.E. White Co.*, 296 U.S. 268, 275 (1935)).

regimes, most states also impose penalties for failure to comply.[43] And no state is required to enforce another's penal laws. *Huntington* v. *Attrill*, 146 U.S. 657, 669 (1892); Restatement (Second) of Conflict of Laws § 89 (1967). Under the Master's proposal, the states would thus be left with the prospect of sending attorneys throughout the nation to pursue recalcitrant holders of escheatables without the incentive of penalties for noncompliance.

2. *The Report's Justifications for Its Departure from Ordinary Law and Practice Are Without Substance*

(a) Under well-established and universally-accepted state law and practice, the issuer is neither a creditor nor a debtor once it has paid dividends or interest to the recordholders. Instead, the holder of the unclaimed property, with no obligation to return it to the issuer, is the "debtor."

First, the issuer is not the nominee holder's "creditor." The brokers, banks and depositories here involved are not in any way agents of the issuer acting on its behalf. Rather, the issuer makes distributions to them as record owners, who are fully entitled to the distributions.[44] Once a distribution is made, the issuer has no contractual or legal right to its return.[45] The evidence in this case confirms that these institutions do not act as agents for issuers. Indeed, DTC, the largest depository, stated that it acts "for the benefit of its users or Participants, *not*

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[43] *See* Egon Guttman, *Modern Securities Transfers* ¶ 16.06, S16-2 to S16-29, col. 10 (3d ed. Cum. Supp. 1991).

[44] Alternatively, another holder—a depository—makes a distribution, based on its record, to its participants.

[45] At oral argument before the Master, no counsel disputed this point, though the Master asked it of all. Transcript at 12, 37, 44-47, 87, 95-96 (Feb. 14, 1991). The only exception, of course, is the case of errors by the issuer's paying agent. *See* DeCesare Dep. 140-41, 270.

a depository acting as an agent for issuers." DTC Statement (emphasis in original); *see* DeCesare Dep. 263-64 (issuers do not reimburse DTC for expenses). Its contracts with issuers confirm that it is acting in behalf of its Participants rather than issuers. *See* DTC Ex. 4. Similarly, the stockholders' and banks' contracts with their customers confirm that it is the customers—not the issuers—who are their principals. *See, e.g.*, Tucker Exs. 2, 3; Merrill Lynch Ex. 2; Prudential-Bache Ex. 6; Citibank Ex. 6. No nominee record owner ever returns properly-paid distributions to an issuer.

Second, the issuer is not a "debtor" of the beneficial owner or anyone else once it has paid the record owner. The use of record ownership—as distinct from beneficial ownership—is "universally accepted in the United States." 2 Model Business Corp. Act Ann. § 7.07, at 568 (3d ed. 1991). References to "shareholder" in the corporation laws of substantially all the states are defined as references to the recordholders.[46]

The Uniform Commercial Code, effective in every state and the District of Columbia, allows the issuer to "treat the registered owner as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner." U.C.C. § 8-207(1) (App. A pp. 23a-24a). This right extends to the payment of dividends and other distributions. The debt created by the declaration of a dividend is discharged by payment to the record owner, and the issuer will not be liable to the beneficial owner on account of such payment. The Report acknowledges this. Report 25 (quoting 1990 Com-

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[46] The relevant statutes are listed in Appendix D at pp. 86a-89a. *See, e.g.*, Tex. Bus. Corp. Act Ann. art. 1.02(A)(15) (West 1980) (shareholder means "the person in whose name shares issued by a corporation are registered at the relevant time in the share transfer records maintained by the corporation"); Ala. Code § 10-2A-2(13) (1987) (shareholder means holder of record); Cal. Corp. Code § 185 (1990) (same). Only Massachusetts does not define shareholder.

mentaries of the Permanent Editorial Board to the Uniform Commercial Code, PEB Commentary No. 4).[47]

Finally, commercial practice is fully in accord with these principles. Thus, for instance, debt securities routinely include provisions confirmatory of the issuer's rights in U.C.C. § 8-207. One authoritative source suggests a provision reading:

> The Company, the Trustee and any agent of the Company may treat the person in whose name this Debenture is registered as the absolute owner hereof for all purposes whether or not this Debenture be overdue, and neither the Company, the Trustee nor any such agent shall be affected by notice to the contrary.

American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions* § 2.2 at 134 (1986).

(b) The Master (and the Intervenors) do not deny any of this. They do, however, offer several technical and metaphorical reasons for ignoring it:

First, the Report contends that the role of record owners and other nominee holders should "mirror the (undiscussed) handling of the agents or intermediaries in *Texas* v. *New Jersey*—they become (almost) transparent." Report 37. The Report thus makes a fundamental error: it treats the paying agents and banks holding funds on behalf of Sun Oil in *Texas* v. *New Jersey* as if they were the same as recordholders. *See also id.* at 18 n.15.

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[47] *See, e.g., De Anda* v. *De Anda*, 662 S.W.2d 107, 109 (Tex. Ct. App. 1983); *Cooper* v. *Citizens Nat'l Bank*, 267 S.W.2d 848, 853 (Tex. Ct. App. 1954); *In re DePew's Estate*, 41 N.Y.S.2d 19, 27 (Surr. Ct. 1943); *Garvy* v. *Blatchford Calf Meal Co.*, 119 F.2d 973, 975 (7th Cir. 1941); *see also* 12 Charles R.P. Keating & Gail O'Gradney, *Fletcher Cyclopedia of the Law of Private Corporations* § 5504 (1985 rev. ed.); 7 E.F. White, *Thompson on Corporations* § 5323 (2d ed. 1927). The notion that this provision is merely an "affirmative defense" is completely irrelevant. It is true that, in *any* action on a debt, a defense of "payment" must be pleaded affirmatively. *See, e.g.*, Fed. R. Civ. P. 8(c). But "payment" is a substantive discharge of the liability.

Wherever located, paying agents and banks are required to return unpaid money to their principals, either by contract or common law principles of agency. *See, e.g.*, Wellener Dep. 57-64, 92-94, 145-48; Citibank Ex. 3 at C156 (describing typical contractual provision). Paying and transfer agents are, in corporate practice, agents of the company; they keep the company's stock records; they disburse, on behalf of the company, the cash or shares to which the holders of record of the company's securities are entitled. The cash is provided them by the company, and, as to stock dividends, the company gives the transfer agent and registrar an order to authenticate, countersign and distribute new issues of stock by way of a stock dividend. Wellener Dep. 17-18, 55-57, 69-72; Citibank Exs. 2, 3; *see generally* Egon Guttman, *Modern Securities Transfers*, Chapter 9 (Issuer and Its Agents) (3d ed. 1987). DTC is not a paying agent. The discovery in this case confirms that *paying agents* (unlike nominees) return unclaimed distributions *to the issuer*. Wellener Dep. 58, 93, 130.

That is the reason why Sun Oil's paying agents were ignored in *Texas* v. *New Jersey*.[48] The brokers and other holders here, in contrast, do not act for the issuer. It is not the issuer's money that they hold; indeed, their claims to the money are good against the whole world, save the beneficial owner [49] or the escheating state.

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[48] If the paying agents in the *Texas* case had any creditor, it was Sun Oil itself; but Sun Oil in turn was a "debtor" of the "lost" or "unknown" persons to whom it owed the funds. It was this as certainly as if it had kept the funds it owed these people in currency in its office desk drawers. The fact that Sun Oil, in a normal fashion, kept the money in banks does not affect the fact that it was the "debtor." It did not discharge its debts by putting money for them into its bank account. By contrast here, by paying the recordholders, the issuers discharge their debts.

[49] Good against the beneficial owner also if the holder is owed margin debt by the beneficial owner.

Second, the Report substitutes metaphors for legal reasoning. The process is said to be a "continuum"; the holders are mere "intermediaries" or "conduits" of the money. But all holders of cash are "conduits." That is the nature of money—it passes from one hand to another. The nominee system's purpose is *not* to promote the distribution of dividends, *see supra* pp. 13-17, but nominees still must make distributions; and they do so as obligors to their participants or customers. The Report also considers nominees "bailees" as to the distributions. Report 28. The term "bailee" might be descriptive of someone holding a sheaf of currency in his briefcase, but what is involved here is money which is kept in bank accounts and, indeed, used in the business of the depositories and brokers holding it. What is involved is a set of relationships between "creditors" and "debtors."

If they demonstrate anything, these metaphors demonstrate only the Report's inconsistency with *Pennsylvania* v. *New York*. Indeed, the Report acknowledges that Western Union was *more* of an "intermediary" than the holders are in this case. Report 36 & n.34. Yet, in that case, when the backup rule applied, it was the "intermediary's" state that was permitted to escheat. If the Master's reasoning in this case had been applied to *Pennsylvania* v. *New York*, then the "debtor" would have been the *sender*, or "originator" of the money. It was not. Senders—like payees—were "creditors" of Western Union; their states were entitled to claim where there were addresses and the *primary* rule could apply.

(c) The Intervenors also made several technical arguments in support of their "interpretation," although even the Master does not embrace these. *First*, they pointed to Section 7.23 of the Model Business Corporation Act ("MBCA"), which was introduced into the text of the MBCA as part of the overall 1984 revision of the Act, as a successor to an amendment to the 1969 version of

the MBCA, promulgated in 1973.[50] Like its predecessor, Section 7.23 allows (but does not require) a corporation to "establish a procedure by which the beneficial owner of shares that are registered in the name of a nominee is recognized by the corporation as the shareholder."[51] This provision is irrelevant here. It is wholly optional upon the issuer (*and* the beneficial owner, who must "opt in"). Despite the fact that these provisions have been on the books in at least some states for close to twenty years, there is no evidence in the record that any of them have been used at all by *any* publicly-held corporation in connection with the distribution of dividends or interest. The reason is obvious: the issuers wish to discharge their obligations of payment of dividends and interest in a way which is convenient and certain and which minimizes the chance that they will have to pay twice. By employing the historic system, reflected in U.C.C. § 8-207(1) and in the statutes to which Section 7.23 is a permissive exception,[52] issuers can discharge their obligations by paying the record owners. Having done so, they are free of any claims except such as may arise from the issuer's fault, or its transfer agent's fault, in not properly posting transfers to its record.

Second, the Intervenors pointed to SEC information and proxy rules designed to allow communications between issuers and beneficial owners. SEC Regulations 14A and 14C, 17 C.F.R. §§ 240.14a-1 to 240.14c-101. But

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[50] *See* Section 2(f) of the 1969 MBCA, revised provision, published in *Changes in the Model Business Corporation Act*, 29 Bus. Law. 947 (1974). Between statutes based on old Section 2(f), as revised, and those based on Section 7.23 of the 1984 MBCA, thirty jurisdictions authorize such a procedure. 2 Model Business Corp. Act Ann. § 7.23 at 619-21 (3d ed. 1991). Section 7.23 is at App. A p. 28a.

[51] The Official Comment notes that "[t]raditionally, a corporation recognizes *only* the registered owner as the owner of shares." 2 Model Business Corp. Act Ann. § 7.23 at 617 (3d ed. 1991) (Official Comment). (Emphasis supplied.)

[52] *See supra* p. 38 n.46; Appendix D at pp. 86a-89a.

these rules have nothing to do with dividends. Under these rules, banks and brokers: (1) on request, for a fee, must provide issuers lists of beneficial owners who do not object to disclosure of their identities and positions, 17 C.F.R. §§ 240.14b-1(b)(3)(i), 14b-2(b)(1)(i), 14b-2(b)(4)(ii), 14c-7(b); and (2) must transmit shareholder communications such as annual reports and proxy materials to beneficial owners. 17 C.F.R. §§ 240.14a-7, 14a-13, 14b-1(b), 14b-2(b)(3), 14c-7.[53] App. A pp. 53a-75a.

The first identified portion of these rules, under which issuers may request lists of "non-objecting beneficial owners" ("NOBO's"—not objecting, that is, to disclosure of their identities), is designed to let issuers communicate directly with beneficial owners. The record indicates that actual use of that portion of the rules for issuers to communicate directly with owners who are not of record is highly limited; in most cases the issuers simply send a requested quantity of shareholder communications to the banks and brokers who redistribute it to their customers.[54] But even if one is to assume that there is substantial direct communication from issuers to beneficial owners under these rules, the rules' silence as to *dividends* speaks volumes. The incremental cost of bulk transmission of shareholder communications is nominal, and "overages" in

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[53] Similarly, in the context of such communications, DTC's procedures "preserve the depository's transparency as an element in the chain of communication between corporate issuers and their beneficial owners of their securities." DTC Ex. 17 at 3. On the other hand, the depositories are completely untransparent with respect to the payment of distributions. *See* DeCesare Dep. 470-74.

[54] The Senior Vice President for operations of Prudential-Bache characterized direct mailings by issuers to brokerage-house customers as "rare." Cirrito Dep. 52. An operations officer for Citibank, the only bank custodian whose deposition was taken, also characterized it as "rare" as to Citibank's custodial customers, did not realize that the bank was under any obligation to provide the customers' identities, and apparently had never heard of the term "NOBO." Scott Dep. 123-24.

such communications—the result of double mailings—do not result in escheatable property. If the issuer sends a few hundred too many proxy statements or annual reports to the nominees on its "position list," [55] or if it happens to use the NOBO rules and directly sends mailing pieces to stockholders who are also receiving them from their brokers, it has lost very little. Extra annual reports are "publicity" and may be distributed on a complimentary basis; dividends are not. No provision of the present legal system, state or federal, requires issuers to distribute dividends or interest directly to beneficial owners whose securities are registered in someone else's name, and the record does not reflect that any issuer does.[56] The reasons are obvious. No issuer is willing to accept "overage" in the distribution of money, as it might be with copies of an annual report or of a message to its stockholders recommending against a hostile tender offer.

Third, the Intervenors say that the funds at issue are not the brokers' funds in any sense, because the brokers must keep them in a special segregated account for the benefit of the unknown owners pursuant to Rule 15c3-3 under the Securities Exchange Act. 17 C.F.R. § 240.15c3-3.

The rule means nothing of the kind. In the first place, Rule 15c3-2 allows brokers and dealers to use their customers' "free credit balances" "in connection with the operation of the business of such broker or dealer," so long as the broker or dealer periodically informs each of its customers that it does so. App. A pp. 75a-76a. Even if the broker does not know the identity of the customer to

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[55] Depositories are required by the SEC to provide issuers with a list of the holdings of their participants in the issuer's securities, upon payment of a fee by the issuer. SEC Rule 17Ad-8(b), 17 C.F.R. § 240.17Ad-8(b).

[56] Indeed, Vice President DeCesare of the DTC insisted that "the industry would have a serious problem" with bypassing the record-holders and distributing dividends directly to beneficial owners, and that DTC would not be operationally able to accommodate an issuer who wished to do so. DeCesare Dep. 470-74.

whom it owes the money, it can "use the money in its business" (subject to any other pertinent rules), so long as it sends out the periodic notices to all its customers.

The Intervenors seem to rely on Rule 15c3-3(e), the requirement for a "Special Reserve Bank Account for the Exclusive Benefit of Customers." App. A pp. 76a-78a. However, the calculation of the moneys to be kept in the special reserve account (pursuant to the Rule's Exhibit A) (App. A pp. 78a-79a) is not made on a customer-by-customer basis but is made on an overall basis. Moreover, the account need only be maintained to the extent that total credits (such as customers' free credit balances) exceed total debits (such as margin debt owed by customers).[57] Where brokers maintain substantial debits, they are thus free to use much (and, depending on the circumstances, sometimes all) of the customers' "free credit balances" in the general operation of their businesses.

3. *The "Issuer as Debtor" Recommendation Improperly Ignores State Law*

The relationships giving rise to the property at issue here are created by state law, as is the state's power to escheat. Federal law, which operates "on top" of the state-created system, serves two federal purposes here: it protects persons from deprivation of their property without due process; and it minimizes interstate disputes by providing a stable and predictable means of resolving conflict between states. As in any other property regime, it does so best by minimizing any disruption of the underlying state law and by maximizing predictability for those who must rely on it.

One would think that the *Texas* rule, which has proved abiding for nearly thirty years, would be easily applied

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[57] *Cf.* Cirrito Dep. 78-81. Thus, if a stockbroker had $1 billion in cash credit balances owing by it to wealthy retired persons in the Hamptons, and had extended $1.1 billion in margin credit to traders in Manhattan, there would be no balance whatsoever required in the Special Reserve Account for anybody, even the people in the Hamptons.

to this case. No analysis of "relevant attributes," no "teasing out" of "ambiguities," no "tie-breaker" is needed; well-established, uniformly-applied and easily-understood principles of state commercial, contract and escheat law provide straightforward answers to the questions posed by *Texas* v. *New Jersey*: who is the debtor?; do the debtor's books and records show a last known address?; and, if not, what is the debtor's state of incorporation?

The Report rejects this straightforward approach, insisting that "federal common law" must be different from state law because "[t]here was no reason to believe that the Supreme Court was using these terms ['debtor' and 'creditor'] in any specific state-law sense in its prior escheat opinions." Report 28.

Although the Report acknowledges that federal common law should not "ignor[e] all state law rules,"[58] it proceeds to do just that. Indeed, its conclusion that the state of the *issuer*, rather than that of the *holder*, is entitled to escheat unclaimed funds owed by the holder to unknown creditors ultimately rests on its determination that the federal common law rule need not "track one [*i.e.* the one adopted by all 50 states!] particular manifestation of a state law rule." Report 26. But this case is the classic one for the application of state law to determine who is the "debtor" and who is the "creditor"; it is uniform, it defines the legal rights of the state and private actors involved, and federal policy would be enhanced by its application.

That state law should ordinarily provide the basis for the federal rule is apparent from what Professors Hart and Wechsler have called the "interstitial character of federal law." Henry M. Hart & Herbert Wechsler, *The*

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[58] Report 25-26; *see Connecticut* v. *Massachusetts*, 282 U.S. 660, 670 (1931) ("For the decision of suits between States, federal, state and international law are considered and applied by this Court as the exigencies of the particular case may require.").

Federal Courts & The Federal System 435-36 (1953).[59] Federal law "builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose. . . . [F]ederal law often embodies concepts that derive their content . . . from the states." *Id.* at 436.

In a number of situations, federal law protects rights only to the extent that they exist under state law. Indeed, while the Due Process Clause protects "property" interests, those interests "attain this constitutional status by virtue of the fact that they have been initially recognized and protected by state law." *Paul* v. *Davis*, 424 U.S. 693, 710 (1976); *Board of Regents* v. *Roth*, 408 U.S. 564, 577 (1972) ("Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings-that stem from an independent source such as state law.").

Thus state law does not merely "inform" federal law for purposes of the Due Process Clause, but "defines" it. So it is in this case. It is only where private property interests are recognized by a state, and, at the same time, more than one state claims the right to escheat or take custody of the property, that the states face a conflict among themselves over which one may claim intangibles. The inquiry thus begins with and is defined by state law. In light of the nature of the federal interests at stake here (which are fully complementary to and derivative from state law), state law appropriately defines the "debtor" and "creditor" relationships—as it defines "property" interests in other cases where a federal right protects or acts upon such interests.[60]

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[59] This famous passage is now reprinted in the third edition (1988) at page 533.

[60] A myriad of other federal rights are, of course, entirely defined by state law. *See, e.g., Appleby* v. *City of New York*, 271 U.S.

Where federal purposes are best achieved by incorporation of state law, this Court does not hesitate to do so—even in situations where state law is *not* the source of rights under federal law, as it is here. *See, e.g., Board of County Comm'rs* v. *United States*, 308 U.S. 343, 349-52 (1939) (per Justice Frankfurter).

The "appropriate[ness]" of giving "due regard for local institutions and local interests"[61] is at its apex where traditional state interests—such as property rights or the regulation of corporations—are at issue. The Court is, in fact, reluctant to "federalize" the common law in areas traditionally regulated by the states, like corporation law and property law. Rather, the Court will incorporate state law into the federal rule, even if state law does not operate *ex proprio vigore*. *See, e.g., Kamen* v. *Kemper Fin. Servs.*, 111 S. Ct. 1711, 1717 (1991) ("The presumption that state law should be incorporated into federal common law is particularly strong in areas in which private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards.").[62]

Most recently, this Court confirmed that "[i]n the absence of any controlling federal law, 'property' and 'interests in property' are creatures of state law." The Court therefore looked to the Uniform Commercial Code for determination of whether and when transfers of "property" occurred for purposes of federal bankruptcy law. *Barnhill* v. *Johnson*, 112 S. Ct. 1386, 1389 (1992).

364, 380 (1926) (Contract Clause); *Ford* v. *Ford*, 371 U.S. 187 (1962) (Full Faith and Credit Clause).

[61] *Board of County Comm'rs*, 308 U.S. at 361.

[62] *Accord Oregon ex rel. State Land Bd.* v. *Corvallis Sand & Gravel Co.*, 429 U.S. 363, 378 (1977) ("Under our federal system, property ownership is not governed by a general federal law, but rather by the laws of the several States. 'The great body of law in this country which controls acquisition, transmission, and transfer of

Here, no federal interest calls for the creation of new federal rules as to who is a debtor to be developed on a "case-by-case" basis; indeed, the opposite is true. *Texas* v. *New Jersey*, 379 U.S. at 679. Even if state laws were not uniform (as they are here) we submit that the federal law of escheat should still build upon the laws of the various states and apply to whoever was a debtor or creditor under those laws. But here the pertinent state law is exactly the same in all 50 states. To propose a federal common law that varies from *uniform* state law would appear to add a "big brother" element to analytical error.

4. *"Fairness" as a "Tie-Breaker"*

With the technical rationale of the Master's recommendation put aside, as we submit it must be, the Master's recommendation amounts to an intuition that the rule contended for by Texas is "as a matter of fairness" preferable. Report 35.

The "fairness" conclusion is reached essentially in populist terms—that it would be best to send the money back where it came from. Doing this was said to be

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property, and defines the rights of its owners in relation to the state or to private parties, is found in the statutes and decisions of the state.'") (quoting *Davies Warehouse Co.* v. *Bowles*, 321 U.S. 144, 155 (1944)); *Callaway* v. *Benton*, 336 U.S. 132, 138-39 (1949) (state law, not federal law, determines rights of shareholders to vote on corporation's reorganization plan); *see also Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 557-79 (1985) (Powell, J., dissenting) (arguing for limits on powers of Congress and emphasizing the "need to protect traditional [state] governmental functions").

Even where rights traditionally regulated by the states are not at issue, "the municipal law relating to like questions between individuals is to be taken into acount, [although] it is not deemed to have controlling weight." *Connecticut* v. *Massachusetts*, 282 U.S. at 670 (water rights between states). Here, the Report gives no weight at all to state law.

"particularly appealing in the case of unclaimed payments on municipal obligations." Report 35. In essence, even though the state has, for example, borrowed $10 million and owes a three percent semiannual payment on its bonds, once it pays its recordholders the $300,000 in question, it is entitled to a discount should some of the money not find its way into the pockets of the beneficiaries, or should some person receive more than his share. The fairness of giving the money back to the issuing state or to the state in which an issuing municipality is located in such a situation is hardly evident.[63] It hardly seems fair to reverse some of a debtor's obligations simply because a breakdown has occurred in the distribution chain after the debtor has discharged its debt by paying the recordholders. It could be argued with some force that the case where the issuer is the state is, from a legal standpoint as opposed to a populist one, the least appealing case for the application of the Master's rule.

The argument of "send it back where it came from" has been heard in this Court before. The Report claims that its recommendation

> is more consistent with the precedent to support escheat (or custodial taking) by the jurisdiction that was connected with the entity that was the originator of the transaction (or the original owner of the funds) over the jurisdiction that was connected with the entity that simply holds the funds at the time no further distributions are possible.

Report 38. This very premise was put forward by the State of Texas in *Texas* v. *New Jersey*: "Texas argues in particular that at least the part of the intangible obligations here which are royalties, rents, and mineral pro-

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[63] The Report's more frank recommendation for a change in the applicable law, to determine, as to corporations, the domiciliary state by reference to a test other than the state of incorporation, seems to be based on an effort to apply the Master's same notions of "fairness." *See* Report 35 n.32; Part B, *infra* pp. 61-69.

ceeds derived from land located in Texas should be escheatable only by that State." 379 U.S. at 679 n.9. The Court rejected Texas' proposed "exception to [the] general rule concerning escheat of intangibles." *Id.* Here, the Report has taken an "exception," not then permitted by the Court, and turned it into the general rule—since the intangibles originate from a state unconnected with the holder, the Report posits that the "originating" state is entitled to escheat.[64]

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[64] In addition, this "policy" operates from a false premise—that the issuer is necessarily the "originator of the transaction." Often the issuer is, itself, a "conduit." Mutual funds are the most obvious example. The dividends (as opposed to capital gains distributions) that they pay are derived entirely from the dividends and interest they receive on their portfolio securities. The same is the case with "closed-end" investment companies, whose stock is often listed on securities exchanges. Almost 10 percent of U.S. corporate stock is held by mutual funds. *See Flow of Funds* at 44. Since, under the Investment Company Act, mutual funds and closed-end investment companies generally use bank custodians, Investment Company Act of 1940, § 17(a)(1), 15 U.S.C. § 80a-17(a)(1), their portfolio holdings are included in the overall figures as to the percentage of corporate stocks held by nominee intermediate holders.

Other examples of the "issuer as conduit" abound. One of the leading securities phenomena of the 1980s was the growth of Collateralized Mortgage Obligations ("CMO's"). *See* Michael Lewis, *Liar's Poker*, at 103-51 (1989). The current volume of these obligations outstanding is $1.1 trillion, *Flow of Funds* at 46. These obligations consist of undivided interests in pools of residential mortgages. The underwriters for these obligations frequently seek geographic diversification of the pools to make them more marketable. *See* Kenneth G. Lore, *Mortgage Backed Securities* at 3-14, 9-22 (1991 ed.). The trust in which the mortgage obligations are placed is the "issuer." To treat the issuer trust as the "debtor" and to send the escheated funds to the state of the trustee on the theory that one is "sending the funds back where they came from" is ludicrous in the CMO situation. In addition to CMO's, issues of other securitized receivables are now common, including pass-through securities involving car loan receivables, general credit card receivables, and the like. *See* William W. Bartlett, *Mortgage Backed Securities* 44 (1989). The Master's theory completely ignores and breaks down on securities such as these.

At bottom, the Master's recommendation appears to be for an alteration, not an application, of the rules established by this Court. It is one that proceeds from principles that, even if meritorious, ought, institutionally, to be implemented by Congress in making an exception to the rules—as it did in the money order situation—rather than by this Court.

B. The Master's Recommended "Modification" of the Backup Rule to Replace the State of Incorporation with the State of Principal Executive Office Must Be Rejected

The backup rule provides that if the creditor is unknown or its last known address cannot be found, "the State of the debtor's incorporation may take custody of the funds." *Pennsylvania* v. *New York*, 407 U.S. at 210-11. The Report urges the Court to discard this rule and substitute "the jurisdiction of the entity's principal domestic executive offices." Report 49. No party sought this departure from the *Texas* and *Pennsylvania* backup rule until the Master, *sua sponte*, suggested it in his draft report.[65] Although the Texas group of Intervenors did not suggest the change, opportunism soon prevailed, and they now embrace the Master's desire to leave by the wayside the "salutary rule of *Texas* v. *New Jersey*" (Brief of *Amici* at 10).

The Report recommends that this Court, in a way which the Report claims is "minor," depart from the doctrine of *stare decisis*. We discuss later the constraints of *stare decisis*, which are involved both on this point and in the Master's unacknowledged change in the backup rule—declaring the "issuer" to be the "debtor." For the moment, we note that the Report does not suggest, within

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[65] The Master also denied Delaware's request for discovery and an opportunity to demonstrate the detrimental effects of the proposed change; he considered such inquiry to be "pointless." Discovery Order No. 15 (Jan. 28, 1992) at 1.

the framework of this Court's decision in *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 173 (1989), that there has been any intervening development in the law or any confusion created by an unworkable decision. Instead it seems to rest solely on an implicit suggestion that the holding in the *Texas* and *Pennsylvania* cases has become "outdated and after being tested by experience, has been found to be inconsistent with the sense of justice or with social welfare." *Patterson* v. *McLean Credit Union*, 491 U.S. at 174 (internal quotations omitted).[66] But even here the Master's discussion does not establish that continued application of the "state of incorporation" rule is inconsistent with the sense of "justice" or with "social welfare."

1. *Intervening Developments in the Law Fully Comport with* Texas v. New Jersey's *Corporate Domicile Rule*

In *Texas* v. *New Jersey*, the Court rejected the rule the Master now recommends (albeit in a slightly different permutation). 379 U.S. at 680. The Report points to no development in the law that has "removed or weakened the conceptual underpinnings" of the corporate domicile rule, or that has rendered it "irreconcilable with competing legal doctrines." *Patterson* v. *McLean Credit Union*, 491 U.S. at 173. In fact, the conceptual underpinnings of the rule retain complete vitality.

Even if the Report were correct that the Court's choice of the state of incorporation rule was essentially arbitrary in 1965 (Report 41), it points to no intervening legal developments rendering that choice invalid today. But, like the Report's deconstruction of the word "debtor," its recommendation that this time-honored rule be dis-

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[66] Whether this is a valid basis for the overruling of a precedent at any time where the matter is one capable of correction by Congress was treated as questionable by the Court in *Patterson* v. *McLean Credit Union*, 491 U.S. at 174.

carded proceeds from a fundamental misunderstanding of the source of the *Texas* rule. The Report erroneously assumes that the backup rule was merely a "*proxy for location*" (Report 41 (emphasis by the Master)). That is not the case. The *Texas* rule developed out of the traditional relationship between a corporation and the state which gave rise to its existence.

The Court's early escheat decisions recognized that a state has power over its corporate citizens holding unclaimed funds to require them to turn such funds over to the state, *Security Sav. Bank* v. *California*, 263 U.S. 282, 285 (1923), and that the power of a corporation's state of incorporation—"jurisdiction over the debtor"—"provides not only the basis for notice to the absent owner but also for taking over the debt from the debtor." *Standard Oil Co.* v. *New Jersey*, 341 U.S. at 439. Such funds are, in Justice Jackson's words, "constructively within the state" (*Connecticut Mut. Life Ins. Co.* v. *Moore*, 333 U.S. at 560) precisely because they are possessed by its corporate citizen.

The *Texas* backup rule built on these decisions, allowing the state of corporate domicile to take possession of the funds in situations where the primary rule could not be applied. Since the *Texas* decision, this Court has aptly summarized the state's historical power over its corporate citizens, and the reasons for such power:

> "A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

CTS Corp. v. *Dynamics Corp. of Am.*, 481 U.S. 69, 89 (1987) (quoting *Trustees of Dartmouth College* v. *Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819)).

And, fundamentally, the *CTS* decision underlined the role of the incorporating state in our corporation-law system: "It thus is an accepted part of the business landscape in this country for the States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters . . . ." 481 U.S. at 91. The *CTS* decision recognized the incorporating state's unique power to regulate corporate governance in the face of federal legislation claimed to be preclusive of the exercise of that power. *CTS* does not stand alone: other cases decided by this Court and the courts of appeals in the years since the *Texas* case have upheld the powers of the incorporating state, and its legislation, against suggestions that a "federalized" rule should supersede them. *See Burks* v. *Lasker*, 441 U.S. 471, 478 (1979); *Santa Fe Indus.* v. *Green*, 430 U.S. 462, 478-79 (1977); *Cort* v. *Ash*, 422 U.S. 66, 84 (1975); *Sadler* v. *NCR Corp.*, 928 F.2d 48, 53-54 (2d Cir. 1991); *Business Roundtable* v. *SEC*, 905 F.2d 406, 412 (D.C. Cir. 1990) (invalidating SEC's one share/one vote rule because it would "impinge severely on the tradition of state regulation of corporate law"); *Amanda Acquisition Corp.* v. *Universal Foods Corp.*, 877 F.2d 496, 506-07 (7th Cir.), *cert. denied*, 493 U.S. 955 (1989); *Tyson Foods, Inc.* v. *McReynolds*, 865 F.2d 99, 101-02 (6th Cir. 1989).

While it is true that states *also* have personal and legislative jurisdiction over foreign corporations doing business in the state, the well-recognized and firmly-established relationship between the corporation and its chartering state was, for purposes of the backup rule, chosen by this Court in *Texas* as superior, and nothing has changed to undermine that choice. The escheat of unclaimed funds in the hands of the state's corporate citizens is a natural and well-established function of its sovereign power.

2. *Discarding the Rule of Corporate Domicile Would Be an Administrative Disaster*

The Report's primary justification for its recommendation to jettison the rule of corporate domicile is the "substantial experience with rules that look to the debtor's chief (or principal) executive office." Report 42. The Report in no way suggests that the traditional rule is "unworkable," but mistakenly asserts that its alternative would cause very little disruption to a system that has worked exceptionally well. The Report relies primarily on Section 9-103(3) of the Uniform Commercial Code. App. A pp. 24a-26a. Section 9-103 is a "choice of law" section catch-lined "Perfection of Security Interest in Multiple State Transactions." The particular subsection on which the Master places such great emphasis is § 9-103(3), dealing with "accounts, general intangibles and mobile goods." Other subsections deal with documents, instruments and ordinary goods; certificates of title; chattel paper;[67] minerals; and uncertificated securities. Subsection (3) says that the law of the jurisdiction in which the debtor is "located" governs the perfection of security interests in "accounts, general intangibles and mobile goods," and subparagraph (d) of that subsection says that a debtor is located at "his place of business if he has one, [and] at his chief executive office if he has more than one place of business."

If the Master is attempting to find support by way of legal analogy in this section of the Uniform Commercial Code, it is hard to find much analogy to the securities business in "accounts, general intangibles and mobile goods"; securities are not included in any of these categories. If anyone were to look into Section 9-103 for legal analogies pertinent here, the subsection about "uncertificated securities" might be thought to be more germane. But that subsection (§ 9-103(6)) says that one

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[67] This is the only subsection that applies the same rules as subsection (3), and that only in certain cases.

looks to the law "of the jurisdiction of organization of the issuer" to determine the perfection of a security interest in such a case. It is surprising that the Master did not refer to this subsection.

We suppose the Master cited U.C.C. § 9-103(3) simply in an effort to demonstrate that the test of "chief executive office" is not unworkable. One might have hoped that there was a better reason for changing a rule than that the new one was not unworkable, particularly since reference to the state of incorporation produces a very workable rule. But the fact of the matter is that § 9-103(3)(d) is hardly an example of "precision and ease of determination." Report 43. The reason that U.C.C. § 9-103(3)(d) has not resulted in tremendous uncertainty has nothing to do with whether it is easy to determine a corporation's "chief executive office." Instead, the uncertainty created by the test under this statute (and acknowledged in the Official Comments to it) is avoided by an option that is simply not available in the escheat context—the expedient of filing duplicate financing statements in more than one state.[68] As Official Comment 5(c) explains:

> The term "chief executive office" is not defined in this Section or elsewhere in this Act. Doubt may arise as to which is the "chief executive office" of a multistate enterprise, but it would be rare that there could be more than two possibilities. *A secured party in such a case may easily protect himself at no great additional burden by filing in each possible place.* (Emphasis supplied.)

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[68] "The easy answer, according to the Official Comment, is for the lender to file in all relevant states. . . . [W]henever there is doubt, the lender should file in every relevant jurisdiction." C.A. Schipani, *The Lender's Dilemma: National and International Automated Data Complications in Perfecting a Security Interest in Accounts*, 22 New Eng. L. Rev. 273, 282-83 (1987) (footnotes omitted); *see In re Peregrine Entertainment, Ltd.*, 116 B.R. 194, 198 n.4 (C.D. Cal. 1990) (creditor filed in two places).

Cases and commentary confirm the fact-based and subject-to-litigation nature of the "chief executive office" test, which of course may easily be avoided with multiple filings in the U.C.C. context. "The question of where the debtor['s] . . . chief executive office is, will be a factual one, determined by the trier of fact." 8 William D. Hawkland, *et al.*, *UCC Series* § 9-103:09 at 165 (1990). Thus, the courts have employed a multifactor test to determine which office is the "chief executive office." [69] The analogy to multiple filings under the U.C.C., when we move to the interstate escheat situation, is multiple claims and litigation.

In recommending this rule change, the Master may have been tempted by the "principal place of business" test adopted in the 1974 "Western Union" statute, 12 U.S.C. § 2503, and introduced into the Judicial Code in 1958 as one of the two bases of determining corporate citizenship for purposes of the diversity jurisdiction. 28 U.S.C. § 1332.[70] But the "principal place of business" test is a notorious breeder of litigation. In the Section 1332 context, a *Westlaw* search indicates that there are approximately 200 decisions in the district courts and approximately 60 in the courts of appeals construing the language in question. While it may be the case that a "principal executive office" test might engender somewhat

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[69] *E.g.*, *Mellon Bank, N.A.* v. *Metro Communications*, 945 F.2d 635, 642 (3d Cir. 1991) (factual test not to be applied rigidly), *cert. denied*, 112 S. Ct. 1476 (1992); *In re Golf Course Builders Leasing, Inc.*, 768 F.2d 1167, 1171 (10th Cir. 1985) (applying various factual criteria); *In re J.A. Thompson & Son*, 665 F.2d 941, 950 (9th Cir. 1982) (same); *Westinghouse Credit Corp.* v. *Rovi Prop. & Mgt. Corp.*, 607 S.W.2d 682, 683 (Ky. Ct. App. 1980); *In re Ericson*, 6 B.R. 1002, 1009 (D. Minn. 1980) (approving settlement because "trier of fact would have some difficult decisions to make"); *In re Astrocade, Inc.*, 31 B.R. 245, 250-51 (Bankr. S.D. Ohio 1983) (listing nineteen factors).

[70] It will be recalled that "principal place of business," used by the Court interchangeably with "main office" and "principal offices," was one of the primary-rule alternatives considered and rejected in the *Texas* case. *See* 379 U.S. at 680.

less controversy than "principal place of business," controversy would remain. Controversies under Section 1332 occur, by definition, where there is already a lawsuit. But in formulating the rules in the *Texas* case, the Court stressed that its choice was motivated by a desire to *avoid* uncertainty and litigation.

The Report acknowledges the uncertainties its test would create, but erroneously asserts that they may be overcome by resort to SEC filings such as Form 10-K, in which the issuer lists a "principal executive office." Report 44. The Report also acknowledges that SEC filings are not an "all-encompassing" solution to the uncertainty created by its recommended test. Report 48. But it considers "a general inquiry [into a corporation's principal executive office] . . . neither burdensome nor complex." Report 49. Of course, one of the bases for rejecting the "principal place of business," "main office" or "principal offices" test in *Texas* v. *New Jersey* was not the *degree* of burden or complexity imposed by the inquiry, but the fact that the inquiry need be made (and litigated in this Court) at all. *Texas* v. *New Jersey*, 379 U.S. at 680.

Even in the context of public corporations filing 10-K reports, administration of a "principal executive office" rule would not be easy. In submissions to the Master, Delaware identified 94 companies that—according to two computer databases with data taken directly from SEC disclosure statements—had more than one principal executive office reported during the same period of time; that number more than doubled when other standard reference sources were included; and we identified 785 companies that changed principal executive offices in the years 1988 to 1991, according to these same standard reference sources. The Report discounted the "judgment calls" that would be made in these cases as not diminishing the "substantial certainty" it asserted would be created. Report 48. But the result of adopting the "principal executive office test"—even in the case of issuers of pub-

licly-traded securities and especially in the case of holders that do not issue such securities—would be hundreds of factual resolutions that would have to be made each year. Referring these cases to Special Masters or District Judges would be a waste of resources.

But the difficulty does not stop there. The Master appears to have confused the contours of this case—which extended only to the confines of the securities business—with the general issues posed by the backup rule. The Master never asks, let alone answers, the question whether his change in the backup rule is to be a general one, applicable in all circumstances, or one limited to the distribution of dividends and interest on publicly-traded securities. There are few, if any, limiting principles in the Master's recommendation on this subject (*see supra* pp. 22-23), but perhaps the Master was planning to leave the question for further litigation in other contexts.

If, however, we assume that the change in the backup rule is to be generally applicable, we will quickly be drawn into waters where 10-K reports, whatever help they may be in any event, will not even be available. Those reports are only filed by issuers of publicly-traded securities. The states collect roughly a billion dollars annually from the holders of *all* kinds of unclaimed property. *See* National Association of Unclaimed Property Administrators, *NAUPA News*, Aug. 1988, 4-5 (fiscal year 1986-87); National Association of Unclaimed Property Administrators, *NAUPA Unclaimed Property Brochure* (fiscal 1989-90). Often these moneys will be held by privately-held corporations or other private business entities. Moreover, a very substantial portion of the states' escheat revenues comes from banks and insurance companies—which are generally structured as subsidiaries of holding companies.[71] Even when these holders are subsidiaries of

[71] Again, the Master did not permit Delaware to make a general record on this point; Delaware, though, receives more than 10% of its escheat revenues from banks and insurance companies.

public companies, they may well have different principal executive offices from their publicly-held parents. *See, e.g., Mellon Bank, N.A.* v. *Metro Communications, Inc.*, 945 F.2d 635, 642 (3d Cir. 1991) ("[a]scertaining the location of the headquarters of a wholly-owned subsidiary necessarily differs from determining the location of the chief executive office of a single corporation"), *cert. denied*, 112 S. Ct. 1476 (1992). Banks do not need to file 10-K reports if they are simply subsidiaries of public companies and have not issued securities themselves; neither do insurance companies. In none of these contexts will any 10-K report be available to assist us.

3. *Fairness Demands Retention, Not Rejection, of the Corporate Domicile Rule*

Again, at bottom, the Master's recommendation stems from his particular notions of "fairness," Report 46, and his apparent disapproval of the amount of escheat revenue sought or received by Delaware in this context. This "policy" justification is highly questionable: there is no relationship between the place of a corporation's principal executive office and the benefits derived by its shareholders from the state's laws; and Delaware's preeminence in attracting corporations is not an accident. If a policy change is to be made here, it should be left to Congress.

The Report argues that its "chief executive office" test will be "much more fair" because it "seems calculated to identify the jurisdiction where the benefits are created" and "is more likely to distribute the funds, in this and other cases, fairly among the various jurisdictions." Report 50. Neither policy justification is correct. A state's corporation laws contribute substantially more to the benefits created for shareholders than the Report suggests and the jurisdiction where the "chief executive office" is located contributes much less than the Report contends. Moreover, "fairness" does not mean "spread revenue equally."

(a) *The State of Incorporation Provides Significant Benefits to Shareholders.*—To begin, the Report fails to recognize the tangible benefits provided to shareholders by a state's corporation laws.

Delaware's preeminence in attracting corporations is not based on mere happenstance. It is based on choice—the choice of management *and* shareholders.[72] The benefits of incorporating in Delaware have been the subject of scholarly debate and inquiry. Until about 20 years ago it was fashionable in academic circles to suggest that state corporation laws were involved in a "race to the bottom" and that Delaware's corporation law won that race by favoring management at the expense of shareholders.[73] More penetrating academic analysis followed. It emphasized the cost savings permitted by incorporation in Delaware, which inures to the benefit of shareholders. Thus, then-professor (now Judge) Winter concluded that "[t]he chartering decision, therefore, so far as the capital market is concerned, will favor those states which offer the optimal yield to both shareholders and management." Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. Legal Stud. 251, 275 (1976). *Accord* Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 Nw. U. L. Rev. 913, 919-20 (1982) (Delaware's "permissive corporation law maximizes, rather than minimizes, shareholders' welfare").

In a comprehensive empirical study of corporations that have reincorporated in other jurisdictions, Professor Romano sought to solve the "peculiar puzzle that one state, Delaware, has consistently been the leading choice for reincorporating firms for over fifty years." Roberta Romano, *Law as a Product: Some Pieces of the Incor-*

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[72] Changing the place of a chief executive office—unlike changing a state of incorporation—does not require a shareholder vote.

[73] *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 Yale L.J. 663 (1974).

poration Puzzle, 1 J.L., Econ. & Organization 225, 226 (1985). She concluded that the states compete for corporate charters, and that Delaware is, "with extraordinary consistency, the most sensitive to new ideas," *id.* at 240.[74] Moreover, the choice by corporations to move to Delaware is no coincidence: "the advantages commonly enumerated in the proxy boilerplate of reincorporating firms, such as the ready availability of legal opinions and a well-developed case law, are, in fact, critical, for they can reduce the cost of doing business." *Id.* at 250. *Accord* Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 Tex. L. Rev. 469, 484 (1987) ("Probably the greatest benefit that Delaware offers corporations is a highly developed case law that provides not only a useful set of precedents, but also a substantial degree of certainty about legal outcomes.").

For a case study of the balanced nature of the Delaware General Corporation Law, one may look to the 1988 amendment to section 203, known as the Delaware Takeover Statute. The legislative deliberative process took into consideration the views of a broad range of interests, in an effort to achieve a balanced statute. *See generally The New Delaware Takeover Statute* (Practicing Law Institute No. 598, 1988) (containing testimony and commentary on the new statute). The courts have concluded that "[s]ection 203 is an exquisitely crafted legislative response to a variety of perceived problems," and "both promotes stable corporate relationships and protects shareholders." *BNS Inc.* v. *Koppers Co.*, 683 F. Supp. 458, 473 (D. Del. 1988); *accord RP Acquisition Corp.* v.

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[74] She also observed that "Delaware has an additional mechanism that provides assurance to firms that it will not radically revamp its corporation laws. The state constitution requires that any revision of the corporation code be supported by a supermajority vote (two-thirds) of both houses of the state legislature." *Id.* at 241 (citing Del. Const. art. IX, § 1).

Staley Continental, Inc., 686 F. Supp. 476, 485 (D. Del. 1988).[75]

In short, a state of incorporation can play a significant role in providing value to the shareholders of its corporations, and Delaware does so. That corporations choose it and investors find it an appropriate choice speak volumes.

(b) *The State of "Principal Executive Office" Bears No Particular Relationship in Law or Economics to Stockholder Welfare.*—If the Master had recommended that the "state where the principal business operations of a corporation were located" replace the "state of incorpora-

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[75] Where a state ignores a balanced approach, it does so at its peril. An interesting case study is the Pennsylvania Takeover Act of 1990, Pa. Sen. Bill No. 1310 (codified in scattered sections of 15 Pa. Cons. Stat.). *See* Robert D. Rosenbaum & L. Stevenson Parker, *The Pennsylvania Takeover Act of 1990: Summary and Analysis* (1990); Letter to the Governor and Members of the General Assembly of the Commonwealth of Pennsylvania from Forty-Two Professors (Jan. 26, 1990) (the Act "represents an unusually troubling development that could inflict significant harm on Pennsylvania corporations and damage the national economic interest") (on file with counsel of record); John Pound, *Shut Up, Shareholders —This is Pennsylvania*, Wall Street Journal, Dec. 13, 1989, at A14, col. 3.

The effort to enact the statute led to institutional investors threatening to vote with their feet. The California Public Employees' Retirement System (CALPERS) threatened to divest itself of all Pennsylvania corporations. Gregory A. Robb, *S.E.C. Chief Criticizes Bill to Thwart Takeovers*, N.Y. Times, Apr. 3, 1990, at D3, col. 1 ("'We will require the fiduciaries to review the wisdom of further investments in'" Pennsylvania corporations) (quoting Dale M. Hanson, Chief Executive Officer of CALPERS). Enactment of the statute proved an embarrassment to a number of Pennsylvania corporations in the light of this attitude on the part of investors. Ultimately, more than 50 Pennsylvania corporations—including some of the largest ones (Westinghouse, Conrail, H.J. Heinz, PNC Financial, PPG Industries, and Sun Oil)—opted out of either all or a portion of the statute's coverage. Justin P. Klein & Jeffrey P. Greenbaum, *Many Pa. Companies Opt Out*, National Law Journal (Mergers & Acquisitions), Sept. 10, 1990, at 15; *Westinghouse Spurns Statute*, N.Y. Times, June 1, 1991, at D2, col. 3.

tion" rule, it might have been thought to have some relation to the economic, governmental and social climate which created the corporation's products or services and hence its wealth. It also would, of course, have been a departure from *stare decisis*, and would have produced an unadministrable rule, breeding as much litigation as that under Section 1332 of the Judicial Code. The Master decided not to do this, and thinking erroneously that the "principal executive offices" rule might be almost as easily administrable as the "state of incorporation" rule, chose it instead. Perhaps he thought that in economic terms the "state of principal executive offices" was like the "state of principal business operations."

But the "principal executive offices" and "principal place of business operations" of a corporation are two entirely different things. The Master may have an antiquated view of corporate life in which the corporation's managers and executives live close to its plants or factory—perhaps in an upscale part of town, but in the same town nonetheless—and work in top floor offices at the plant, looking out the windows at the smokestacks. That image may have been correct decades ago, but it is not correct now. With the increasingly far-flung nature of business operations; with multiple plants and mines for the traditional extractive and manufacturing sorts of business; with physical production often taking place in a variety of nations; with even service businesses employing large, decentralized clerical staffs wherever they can be hired the most cheaply; and with the great improvements in communications and data transmission, the modern executive suite is increasingly located nowhere near what one might find to be the principal center of the corporation's productive work. Indeed, it increasingly is in a free-standing executive office completely detached from the places where the corporation's productive work is done. The Master perceived a connection between the executive offices and productive activity, and he related that connection to "fairness"; but the connection continually grows more attenuated.

Improved communication technologies have resulted in shrinkage of the top executive group and in frequent relocations of its offices "off-site" from productive plants or facilities. *See* Alan Farnham, *Migratory Habits of the 500*, Fortune, Apr. 24, 1989, at 400 ("Technology makes relocation to remote locations more feasible. With the latest advances in telecommunications, a CEO can run his company from the moon"). This technology has also led to widespread decentralization of the corporate decisionmaking process. As David A. Heenan has observed,

> By the 1960s, several factors began to signal the demise of the bigger-than-life head office. . . . For a decade, U.S. firms slashed away at their headquarters staffs and cut deeply into middle management, at times eliminating entire levels. . . .
>
> The recent wave of mergers and acquisitions, takeovers and leveraged buy-outs (called "LBOs") further stimulated the minimalist movement. Breakup prices of a diversified conglomerate were directly tied to the autonomy of its operating companies. Since stand-alone subsidiaries tended to enhance the value of the parent, there was added incentive to shift power and staff away from the head office to the business units.

David A. Heenan, *The New Corporate Frontier: The Big Move to Small Town, USA* 10-11 (1991).[78]

Moreover, there is no sure connection between a corporation's "designated headquarters" and the place where its actual business occurs or even where its actual decisionmaking takes place. "[O]ne's headquarters can be anything one says it is." Alan Farnham, *Migratory Habits*

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[78] *See also* Robert E. Levinson, *The Decentralized Company* 17 (1983) (describing central features of "radically decentralized" company, including "parent company's role is primarily that of a banker for its operating divisions," and "[d]ecisions are made by hands-on managers ('experts') at the scene rather than by headquarters numbers men ('specialists') far removed from the actual operation.").

of the 500, Fortune, Apr. 24, 1989, at 401.[77] Increasingly, "the single-most important factor in the decision [to relocate the top group's offices] is the arbitrary wishes of the company's chief executive officer." W. John Moore, *Corporate Kidnapping*, National Law Journal, June 13, 1987, at 2. These wishes can be driven by the chief executive officers' personal income tax considerations[78] or "lifestyle" considerations.[79]

Even where executive sybaritism is not the guiding principle, the location of the "principal executive offices" no longer bears any fixed relationship to where the company's operations and productive activities occur. Decisions as to site selection for "principal executive offices" have nothing to do with a determination of whether the

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[77] Illustrative examples include Borden (1,200 employees in Columbus, Ohio; 25 in New York, where "executive office" is designated); W.R. Grace (bulk of former headquarters staff moved to Boca Raton, Florida; "corporate headquarters" in Manhattan with staff of 20 to 50); Louisiana Pacific (corporate headquarters in Portland, Oregon; most operations located in south and south-west); Grumman Corporation (will maintain New York headquarters even though "major operations [located] elsewhere"); Medi-Mail Inc. (bulk of operations moved from San Diego to Las Vegas; six employees at corporate headquarters in San Diego). *See* Del. Supp. Br. (Nov. 5, 1991) at 10-11.

[78] *See* Katherine Barrett & Richard Greene, *Snow White and the 50 Dwarves*, Financial World, Apr. 17, 1990, at 1 ("more often than anyone wants to admit, the decision to move headquarters involves a $5,000 hit in personal taxes on the part of some CEO").

[79] *See* Alan Farnham, *Migratory Habits of the 500*, Fortune, Apr. 24, 1989, at 400 ("golf in January" is the "clincher" in persuading CEOs to move their offices to Georgia); Arthur M. Johnson, *The Challenge of Change: The Sun Oil Company 1925-1977* 242 n.* (1983) (Sun, with operations centered in Oklahoma, maintained Philadelphia headquarters so that executives could eat lunch at the Racquet Club); William H. Whyte, *CITY: Rediscovering the Center* 287-88 (1988) (of thirty-eight corporations that moved headquarters "during the height of the exodus" from New York, "thirty-one moved to a place close to the top man's home," dropping the average CEO commute to about eight miles).

benefits of the state's economy and laws will inure to the shareholders.[80]

(c) *The Master's View of "Fairness" Is Misguided.*— The Master's distaste for the Court's backup rule seems founded not on the assertion that the incorporating state's corporation law does not contribute to the "creation of benefits" (for surely it does), but rather on a notion that the wealth should be shared among the states in a kind of "from each according to his means, to each according to his needs" analysis. The supposed unfairness thus derives from Delaware's preeminence in attracting corporations.

The benefits Delaware provides to shareholders of its Delaware corporations are the direct result of great effort by its public servants. Delaware's corporation laws are "under constant scrutiny and review" in an annual amendatory process,[81] and the Chancery Court serves as a *de facto* national forum for corporation law issues, constituting "the nation's most experienced corporate law tri-

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[80] When we move into the area of mutual funds, closed-end investment companies, CMO's and other pass-through issuers which are themselves conduits (*see supra* p. 51 n.64), the notion of a "principal executive office" having some substantive significance is even more attenuated. In practical terms, the decisions as to buying and selling portfolio securities in mutual funds and other investment companies are generally made by a single portfolio manager. *See* Burton G. Malkiel, *A Random Walk Down Wall Street* 376-84 (5th ed. 1990). The productive activities of the portfolio companies—and indeed, even *their* principal executive offices—are often located somewhere else from where the portfolio manager is. In the case of pass-through debt securities, the centralized functions are essentially clerical—keeping track of incoming payments and distributing them. Here again, the Report is adrift about securities representing enormous portions of the present-day securities market. *See supra* pp. 13-14 n.17.

[81] R. Franklin Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations and Business Organizations* at H-18 (2d ed. 1991); S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 Del. J. Corp. L. 1, 17-21 (1976).

bunal."[82] The state devotes significant resources to provide these benefits. Over the past three years, roughly 65 percent of the trial days spent by the Delaware Court of Chancery were devoted to trials involving corporations incorporated in Delaware. Approximately 57 percent of the opinions written by the Court during the same period resolved issues arising under the Delaware General Corporation Law.[83] And Delaware now spends more than $4 million per year maintaining its Division of Corporations. Delaware works hard to provide a valuable service to its corporations, which to a large extent are the nation's corporations. There is nothing "unfair" about Delaware's requiring them to turn over the unclaimed property of unknowns which they hold.

At bottom, the Report's recommendation is not at all based on the "lawyerlike definition of state power over this subject" that Justice Jackson called for in *Connecticut Mutual Life* and that the Court provided "once and for all" in *Texas* v. *New Jersey*. It is, instead, based on a leveling view of "fairness." Whether that is a wise policy is not for this Court to decide. Indeed, revision now as a result of the Master's variation from the *Texas* rule will lead only to further cases brought in an effort to revise the rule in other ways perceived by other states to be more fair to them. The remedy, if one is needed, lies with Congress.

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[82] Ronald Gilson, An evaluation of Pennsylvania Senate Bill 1310 at 7 (issued to the Pennsylvania General Assembly in connection with the Pennsylvania Takeover Act of 1990) (on file with counsel of record). *Accord* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. Rev. 542, 589 (1990); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 Tex. L. Rev. at 488.

[83] Statement of Richard Kiger, App. E hereto at p. 91a. The opinions in these cases tend to be more elaborate and thus more demanding of the Court's time than non-corporation law opinions. *Id.* ¶ 5.

C. The Master's Recommendations, Both as to the "State of Incorporation" and the "Debtor as Issuer" Points, Violate This Court's Teachings on the Principles of *Stare Decisis*

The Master's recommendations on the two points just discussed include one acknowledged departure from the rule of *Texas* v. *New Jersey*, the rejection of the "state of incorporation" rule, and one unacknowledged departure, the "issuer as debtor" recommendation. There is no occasion presented in this case, however, for this Court to depart from the doctrine of *stare decisis*.

In making its recommendations, the Report does not even acknowledge the "central importance of *stare decisis* in this Court's jurisprudence." *Hilton* v. *South Carolina Pub. Rys. Comm'n*, 112 S. Ct. 560, 563 (1991). "Time and time again, this Court has recognized that 'the doctrine of *stare decisis* is of fundamental importance to the rule of law.'" *Id.* (quoting *Welch* v. *Texas Dep't of Highways & Pub. Transp.*, 483 U.S. 468, 494 (1987)); *see also Patterson* v. *McLean Credit Union*, 491 U.S. 164, 172 (1989); *Burnet* v. *Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting).

While departure from the doctrine of *stare decisis* always requires "some compelling justification," *Hilton* v. *South Carolina Pub. Rys. Comm'n*, 112 S. Ct. at 564, several factors—none of which are acknowledged in the Report—give *stare decisis* special force in this case. First, this Court has already rejected an attempt to "modify" the *Texas* rule based on the same factors that motivated the Master's recommendation here, when it declined to carve out an exception to the backup rule for situations that "involve a higher percentage of unknown addresses." *Pennsylvania* v. *New York*, 407 U.S. at 214. As the Court has explained, "[a] litigant who in effect asks us to reconsider not one but two prior decisions bears a heavy burden of supporting such a change in our jurisprudence." *Walker* v. *Armco Steel Corp.*, 446 U.S. 740, 749 (1980).

Substituting references, the *Walker* Court's rejection of such a request applies with equal force here: "the reasons [Intervenors] assert[] for overruling [*Texas*] are the same factors which we concluded in [*Pennsylvania* v. *New York*] did not undermine the validity of [*Texas*]." *Walker*, 446 U.S. at 749; *accord Flood* v. *Kuhn*, 407 U.S. 258, 282 (1972) (declining to overturn "aberration" of antitrust exemption for major league baseball granted in *Federal Base Ball Club* v. *National League*, 259 U.S. 200 (1922), and adhered to in *Toolson* v. *New York Yankees, Inc.*, 346 U.S. 356 (1953)).

Second, "Congress remains free to alter what [the Court has] done." *Hilton* v. *South Carolina Pub. Rys. Comm'n*, 112 S. Ct. at 564 (quoting *Patterson* v. *McLean Credit Union*, 491 U.S. at 172-73).[84] Although this principle is generally applied in matters of statutory construction, it surely applies here, where the Court's rules operate only in the absence of an "applicable federal statute." *Texas* v. *New Jersey*, 379 U.S. at 677.

The *Texas* rule has been the subject of "something other than mere congressional silence and passivity." *Flood* v. *Kuhn*, 407 U.S. at 283. Congress has modified the *Texas* rule in one limited respect and, in doing so, has acknowledged its general applicability. (This 1974 revision is discussed above at p. 8 & n.5.) Aside from the 1974 statute, Congress has not modified the *Texas* rule and no efforts have been made to do so, notwithstanding Congress' frequent attention to the area of escheat of unclaimed property, which has resulted in myriad instances of congressional displacement of the states' traditional authority where federal interests demanded it.[85] Congress has, of course, acknowledged the

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[84] *Accord, e.g., Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 424 (1986); *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720, 736 (1977); *Edelman* v. *Jordan*, 415 U.S. 651, 671 n.14 (1974).

[85] *E.g.*, Pub. L. No. 101-510, Div. A, Title XV, § 1520(e), 104 Stat. 1485, 1732 (1990) (codified at 24 U.S.C. § 420(e)) (property

authority of the states to escheat under the state statutes passed in the wake of *Texas* v. *New Jersey* (*e.g.*, Pub. L. No. 97-320, Title IV, Pt. A. § 412, 96 Stat. 1469, 1521

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of intestate residents of Armed Forces Retirement Home); Pub. L. No. 100-203, Title X, § 10621(a), 101 Stat. 1330, 1330-452 (1987) (codified at 26 U.S.C. § 6408) (unclaimed federal income tax refunds); Pub. L. No. 98-359, § 2, 98 Stat. 402 (1984) (codified at 31 U.S.C. § 1322) (unclaimed property held by the old postal saving system); Pub. L. No. 98-25, §§ 2, 3, 97 Stat. 185 (1983) (codified at 25 U.S.C. § 373b) (estates of Indians dying intestate without heirs); Pub. L. No. 97-459, Title II, § 206, 96 Stat. 2515, 2518-19 (1983) (codified at 25 U.S.C. §§ 2205, 2206) (enabling Indian tribes to escheat members' property); Pub. L. No. 97-320, Title IV, § 408, 96 Stat. 1469, 1513-15 (1982) (codified at 12 U.S.C. §§ 216 to 216d) (unclaimed property of closed national banks); Pub. L. No. 97-306, Title IV, § 401(a), 96 Stat. 1429, 1442 (1982) (codified at 38 U.S.C. § 1970(h)) (veterans' benefits); Pub. L. No. 93-445, Title I, § 6, 88 Stat. 1305, 1334-38 (1974) (codified at 45 U.S.C. § 231e(a)(5)) (railroad employees' benefits); Pub. L. No. 92-203, § 7, 85 Stat. 688, 691-94 (1974) (codified at 43 U.S.C. § 1606(h)(2)(A)) (stock in Alaska Native Regional Corporations); Pub. L. No. 92-117, 85 Stat. 337 (1971) (formerly codified at 31 U.S.C. § 1322) (unclaimed property held by the old postal saving system); Pub. L. No. 91-240, 84 Stat. 203 (1970) (codified at 25 U.S.C. § 375d) (property of intestate members of certain Indian nations); Pub. L. No. 90-114, § 3, 81 Stat. 335 (1967) (codified at 25 U.S.C. § 1153) (same); Pub. L. No. 90-76, § 3, 81 Stat. 177 (1967) (codified at 25 U.S.C. § 788) (same); Pub. L. No. 89-700, Title II, § 202(b), 80 Stat. 1079, 1087 (1966) (codified at 45 U.S.C. § 352(g)) (railroad employees' benefits); Pub. L. No. 89-717, § 2, 80 Stat. 1114, 1115 (1966) (codified at 25 U.S.C. § 967b) (property of intestate members of certain Indian nations); Pub. L. No. 89-660, § 3, 80 Stat. 910 (1966) (codified at 25 U.S.C. § 1133) (same); Pub. L. No. 89-656, § 3, 80 Stat. 906 (1966) (codified at 25 U.S.C. § 1103) (same); Pub. L. No. 89-554, 80 Stat. 378, 595 (1966) (codified at 5 U.S.C. § 8705(d)) (government employees' life insurance); *see also* Pub. L. No. 85-857, §§ 717, 750, 3202(e), 5294-5295, 72 Stat. 1105, 1152, 1160, 1232, 1258 (1958) (codified at 38 U.S.C. §§ 1917(d)), 1950, 5502(e), 8504-8505) (veterans' benefits and unclaimed property on Veterans Administration premises); Pub. L. No. 84-1028, c. 1041, §§ 2571-2575, 70A Stat. 1, 143-44 (1956) (codified as amended at 10 U.S.C. §§ 2571-2577) (property in custody of United States Military); Pub. L. No. 77-774, c. 640, 56 Stat. 1021, 1021-22 (1942) (codified at 25 U.S.C. § 373a) (estates of Indians dying intestate without heirs).

(1982) (codified at 12 U.S.C. § 484(b)) (allowing state examination of national banks for purpose of assuring compliance with state escheat laws)).

In light of this activity, which has not given rise to any statutory disapproval of the general *Texas* rule, Congress—not the Court—is the appropriate body to revise the *Texas* rule, if revision be needed. *See Hilton* v. *South Carolina Pub. Rys. Comm'n*, 112 S. Ct. at 564 ("Congress has had almost 30 years in which it could have corrected our decision . . . if it disagreed with it, and has not chosen to do so. We should accord weight to this continued acceptance of our earlier holding."); *Flood* v. *Kuhn*, 407 U.S. at 283-84 ("we continue to be loath . . . to overturn those cases judicially when Congress, by its positive inaction, has allowed those decisions to stand for so long and, far beyond mere inference and implication, has clearly evinced a desire not to disapprove them legislatively"); *Toolson* v. *New York Yankees, Inc.*, 346 U.S. at 357 (declining to depart from precedent where "Congress has had the ruling under consideration but has not seen fit" to overturn it for 30 years).[86]

Third, the Report's recommendation would disturb settled expectations that have now grown into a multistate cooperative effort and are reflected on the states' statute books. Every state unclaimed property statute that treats the issue defines the debtor's domicile as its state of incorporation, and every such state has acted in reliance on the

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[86] Congress' general acceptance of the *Texas* rule makes the Intervenors' reliance on *Morgane* v. *States Marine Lines, Inc.*, 398 U.S. 375 (1970), and *United States* v. *Hutcheson*, 312 U.S. 219 (1941), inapposite. In those cases, the Court developed an evolving body of common law in light of sweeping policy changes wrought, in part, by a "series of enactments" (*Hutcheson*, 312 U.S. at 235 (antitrust and labor relations); *Morgane*, 398 U.S. at 388-90 (admiralty)) that bore on the common law's development. This case, in contrast, concerns a simple, comprehensive rule that has sufficed for close to thirty years, with no doctrinal development needed and no congressional disapproval expressed.

Texas rule in this regard. Those statutes refer, also, to *holders*. *See supra* pp. 10, 32. These considerations weigh heavily against the Report's recommendations and were not discussed by the Master. As the Court explained in *Hilton* v. *South Carolina Pub. Rys. Comm'n*, "*stare decisis* has added force when the legislature, in the public sphere, and citizens, in the private realm, have acted in reliance on a previous decision, for in this instance overruling the decision would dislodge settled rights and expectations or require an extensive legislative response." 112 S. Ct. at 564; *accord United States* v. *Maine*, 420 U.S. 515, 527 (1975) ("in the almost 30 years since *California*, a great deal of public and private business has been transacted in accordance with those decisions and in accordance with major legislation enacted by Congress, a principal purpose of which was to resolve the 'interminable litigation' arising over [this] controversy").

The recommended changes would force almost every state to amend its statutes and would require an evaluation of every issuer's principal executive office, going back as far as records permit. The burden of this change would fall hard on Delaware, which has for nearly thirty years relied on the *Texas* rule for a substantial portion of its revenue, and might now face the prospect of the other states looking to it (and thus to its taxpayers) for "recovery" of hundreds upon hundreds of millions of dollars: "if the doctrine of *stare decisis* has any meaning at all, it requires that people in their everyday affairs be able to rely on [this Court's] decisions and not be needlessly penalized for such reliance." *United States* v. *Mason*, 412 U.S. 391, 399-400 (1973) (citing *Flood* v. *Kuhn*, 407 U.S. at 283, and *Wallace* v. *McConnell*, 38 U.S. (13 Pet.) 136, 150 (1839)). The Report does nothing if it does not penalize the taxpayers of Delaware—a penalty supported by no "compelling justification."

These factors give *stare decisis* added force and make the Intervenors' burden a particularly heavy one. They

do not meet it. In *Patterson* v. *McLean Credit Union*, 491 U.S. 164 (1989), the Court laid out the traditional justifications for overruling a prior case. It first explained that the "primary reason" for a departure from *stare decisis* "has been the intervening development of the law, through either the growth of judicial doctrine or further action taken by Congress, [w]here such changes have removed or weakened the conceptual underpinnings from the prior decision, or where the later law has rendered the decision irreconcilable with competing legal doctrines or policies." 491 U.S. at 173 (citations omitted). Here, intervening legal developments support continued adherence to the corporate domicile rule, and do not suggest that a "debtor" is other than a "debtor." *See supra* pp. 53-55.

A second traditional justification exists where the precedent is a "positive detriment to coherence and consistency in the law, either because of inherent confusion created by an unworkable decision, or because the decision poses a direct obstacle to the realization of important objectives embodied in other laws." *Patterson* v. *McLean Credit Union*, 491 U.S. at 173 (citations omitted). No party makes any assertion that the corporate domicile rule is "unworkable" or poses any obstacle to any objectives embodied in other laws; indeed, no one can point to a more "workable" rule than the state of incorporation rule; and retention of the *Texas* rule *furthers* the federal policies that gave rise to it (*see supra* pp. 3-7, 55). The same can be said of the "issuer as debtor" point. *See supra* pp. 45-49.

Finally, the *Patterson* Court observed that sometimes "a precedent becomes more vulnerable as it becomes outdated and after being ' "tested by experience, has been found to be inconsistent with the sense of justice or with social welfare." ' "[87] The Court had reservations about

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[87] 491 U.S. at 174 (quoting *Runyon* v. *McCrary*, 427 U.S. 160, 191 (1976) (Stevens, J., concurring), quoting, in turn, Benjamin N. Cardozo, *The Nature of the Judicial Process* 149 (1921)).

the availability of this ground in cases where Congress might act. 491 U.S. at 174-75. Yet this ground—rightly or wrongly invoked—appears to be the sole basis for the Master's recommendation that the *Texas* rule be overturned. Of course, the Court's reluctance to change a rule within the control of Congress on grounds of "justice" and "social welfare" is fully warranted. *See supra* pp. 71-73. And, as we showed in Parts A and B, the Master has made out no case under this heading, if it is to be considered at all. *See supra* pp. 49-52, 61-69.

Adjustments in this area are matters for Congress. The Court has laid down, and reaffirmed, the fundamental principles. The present case involves an application of them to a particular industry and to particular conditions in that industry. If the Court modifies the principles to deal with this case, it will be called upon to do so in other cases. There is no demonstration that the application of the rules in this case produces a shocking or unexpected result, particularly given the fact that any rule that might be established on this subject admittedly has arbitrary elements. *See Texas* v. *New Jersey*, 379 U.S. at 683. The rules and their application here are well-grounded in the historical jurisprudence of this Court. If an alteration in those rules is to be made because of a contention that it would be more "fair," in some sense, to have another rule for the situation involved in this case, Congress, which provided such a forum after this Court's decision in the *Pennsylvania* case, is available.

II. IF CHANGES TO THE *TEXAS* RULE ARE TO BE MADE, THEY SHOULD NOT BE APPLIED RETROACTIVELY AGAINST DELAWARE

The Master dealt with what he called issues of "reach-back" and "retroactivity." Report 70-77. Discussing both the "issuer as debtor" and "corporate domicile" points, he recommended full retroactive application as to both. Report 72. "Retroactivity" meant not simply that the rule that would govern property that had theretofore become escheatable but had not been taken by one of the

states; it also extended to sums already collected by the states, and this went back without limitation as to time. Although Delaware is a plaintiff here, not a defendant, the Report's recommendations seem aimed at Delaware, as well as New York; the Draft Report had contained a recommendation that Delaware's reliance on the existing rule of corporate domicile be acknowledged,[88] but this was eliminated from the final Report. If the rules are to be changed at all—and they should not be—Delaware should not be subjected to retroactive application of the new rules.

That the Master wrestled at all with the issue of "retroactivity" demonstrates the departure he would have the Court make from the *Texas* rule. "In the ordinary case no question of retroactivity arises. Courts are as a general matter in the business of applying settled principles and precedents of law to the disputes that come to the bar." *James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. 2439, 2442 (1991) (plurality opinion). It is only "[i]n those relatively rare circumstances where established precedent is overruled [that] the doctrine of nonretroactivity" is even considered, "in order to avoid 'jolting the expectations of parties to a transaction.'" *American Trucking Ass'ns* v. *Smith*, 496 U.S. 167, 196 (1990) (plurality opinion) (quoting *United States* v. *Estate of Donnelly*, 397 U.S. 286, 295 (1970) (Harlan, J., concurring)); *accord American Trucking*, 496 U.S. at 222 (dissenting opinion) ("'[t]he usual rule is that federal cases should be decided in accordance with the law existing at the time of decision'") (quoting *Saint Francis College* v. *Al-Khazraji*, 481 U.S. 604, 608 (1987)).

Of course, the most obvious and appropriate way to avoid jolting the expectations of the parties in this case is to adhere to the *Texas* rule: "[c]onsiderations of finality and the justifiable expectations that have grown up surrounding a rule are ordinarily and properly given

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[88] Draft Report 57 n.64, quoted in our Exceptions, *supra* at E-8.

expression in our rules of res judicata and *stare decisis*." *American Trucking Ass'ns* v. *Smith*, 496 U.S. at 212 (dissenting opinion); *see James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. at 2450 (Blackmun, J., concurring in the judgment) ("retroactivity combines with *stare decisis* to prevent us from altering the law each time the opportunity presents itself"). These reasons fully explain why the Court in *Pennsylvania* v. *New York* applied the *Texas* rule to all the property at issue in the case, rejecting New York's assertion that the *Texas* rule was "not retroactive." 407 U.S. at 212-13. Prior to the *Texas* case, there was *no* rule governing conflicting state claims to escheat, and hence no expectations about the subject. The Court thus strictly applied the *Texas* rule.[89] Strict application of the *Texas* rule, until it is changed, is fully consistent with the parties' expectations, as is evident from the widespread adoption of the uniform acts providing that the "holder" of unclaimed, "owner/address unknown" property is to deliver that property to the holder's state of incorporation. *See supra* pp. 10-11, 32. Thus, all the parties except one part of the Texas group agreed with the Master's initial Draft Report that a state's prior reliance on the traditional corporate domicile rule should preclude any retroactive application of the

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[89] One subgroup of the Intervenors suggested that this routine application of law to fact somehow establishes that "nonretroactivity is unsuited to this very unique area of the law . . . due to the very considerations of fairness that propelled the Court's ruling" in *Texas*. Tx. Supp. Br. (Nov. 4, 1991) at 12. That is absurd. The Court in *Pennsylvania* did not evaluate "retroactivity" issues because it was simply adhering to the only precedent that existed; it had no occasion to consider whether this area of the law is so "unique" that ordinary legal doctrines once established should be retroactively displaced in favor of the shifting sands of what appeals as "fair" in a particular case. In addition, the Intervenors' suggestion (*id.* at 11-12) that all states acquire unclaimed property under custodial taking statutes as "conservators" is flat wrong. Several states have true escheat statutes, cutting off the claims of all others. *See supra* p. 2 n.1.

Master's recommendation to depart from that rule.[90] *See* our Exceptions, *supra* at E-8 (quoting Draft Report 57 n.64).

Should the Court depart from the *Texas* rule by adopting either of the changes, acknowledged or unacknowledged, recommended by the Master, the circumstances of the case call for nonretroactivity for Delaware and any state similarly situated. The proper scope of the Court's leading decision on the subject, *Chevron Oil Co.* v. *Huson*, 404 U.S. 97, 105-10 (1971), has generated substantial recent debate. But whether *Chevron* is properly viewed as authorizing the prospective application of a new *rule of law* to litigants before the Court,[91] or only as announcing an equitable discretion as to the *relief* that a federal court should award when applying the new law,[92] it should be applied here to protect Delaware from a departure from the *Texas* rule, if a departure is made.

Under *Chevron*, a three-factor analysis is made:

> First, the decision to be applied non-retroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression

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[90] Ala. Supp. Br. (Nov. 4, 1991) at 29 n.19; Cal. Supp. Reply Br. (Nov. 21, 1991) at 18-19. The Texas group made the frivolous assertion that the change is "merely a refinement rather than a reversal." Tex. Supp. Br. (Nov. 4, 1991) at 14. No support is given for this view, and we are hard pressed to imagine what could possibly constitute a new rule if not one that would render invalid every state statute concerning the backup rule written after the *Texas* decision.

[91] *See James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. at 2448-49 (White, J., concurring in the judgment); *id.* at 2453-56 (O'Connor, J., dissenting).

[92] *James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. at 2448 (opinion of Souter, J.); *American Trucking Ass'ns* v. *Smith*, 496 U.S. at 222-24 (Stevens, J., dissenting).

> whose resolution was not clearly foreshadowed. Second, . . . we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. Finally, we [must] weig[h] the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity.

Chevron Oil Co. v. *Huson*, 404 U.S. at 106-07 (citations and internal quotations omitted).

First, both recommendations are to overrule clear precedent. As we have demonstrated above, the alleged "ambiguity" leading to the "issuer as debtor" recommendation is one created by the Report, not the *Texas* rule. The plain meaning of the word "debtor" was applied by the drafters of two uniform acts and the legislatures of the states that have adopted those statutes to mean "holder," and that application comports with this Court's longstanding precedents. *See supra* pp. 2-6, 32-34. And it is difficult to imagine a clearer precedent than the backup rule's provision that "the State of the debtor's incorporation may take custody of the funds." *Pennsylvania* v. *New York*, 407 U.S. at 210-11. That rule (and the uniform acts incorporating it) would no longer be the law if the Master's recommendation is accepted.

Second, the "purpose and effect" of the *Texas* rule was to provide certainty to states and private persons faced with conflicting escheat claims. *See supra* pp. 2-6, 45-46. Indeed, from the time the Court first confronted the need for a rule of priority among states in *Connecticut Mutual Life* to the time it fashioned a rule "once and for all" in *Texas* v. *New Jersey* (and adhered to it in *Pennsylvania* v. *New York*), if one thing was recognized, it was the need for a clear, certain and simple rule. Surely that purpose would not be served by providing incentives to the states to urge revisions to that rule in litigation

before this Court, by permitting them to make retroactive claims on property which had already been escheated to another state, no matter how many years before.[93]

Third, retroactive application of the Master's proposed change of the backup rule against Delaware and states similarly situated would be harshly inequitable. The Court is sensitive in this context to the special needs of state governments: "state officials and those with whom they deal are entitled to rely on a presumptively valid state statute, enacted in good faith and by no means plainly unlawful." *Lemon* v. *Kurtzman*, 411 U.S. 192, 209 (1973) (plurality opinion). "To the extent that retrospective application of a decision burdens a government's ability to plan or carry out its programs, the application injures all of the government's constituents. These concerns have long informed the Court's retroactivity decisions." *American Trucking Ass'ns* v. *Smith*, 496 U.S. at 185 (plurality opinion); *see James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. at 2448 (opinion of Souter, J.) ("[n]othing we say here deprives respondent of [its] opportunity to . . . demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided"); *cf. Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969) ("Significant hardships would be imposed on cities, bondholders, and others connected with municipal utilities if our decision today were given full retroactive effect.").

Delaware and the other states have promulgated and implemented their escheat statutes in reliance on this

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[93] In no way can the Court's caveat in *Pennsylvania* v. *New York* that a state may escheat unclaimed property "'until some other State comes forward with proof that it has a superior right to escheat'" 407 U.S. at 210-11 (quoting *Texas* v. *New Jersey*, 379 U.S. at 682), be read to contemplate that such "proof" would be found in an overruling of the *Texas* rule itself. The Decree in *Pennsylvania* makes clear that the "proof" required had to do with moving property out of the category of the "backup rule" into the category of the "primary rule"—by reason of either the identification of a last-known address or the intervening passage of an escheat statute by the state of last-known address. *See supra* p. 7 n.4.

Court's precedents in *Texas* and *Pennsylvania*. Because they could not "be expected to foresee that a decision of this Court would overturn established precedents, the inequity of unsettling actions taken in reliance on those precedents is apparent." *American Trucking Ass'ns* v. *Smith*, 496 U.S. at 182. As in *American Trucking*, "the invalidation" of Delaware's escheat law "would have potentially disruptive consequences for the State and its citizens." *Id.*; *see supra* pp. 73-74. In contrast, the Intervenors seek retroactivity in order to collect a windfall from Delaware—a windfall they had no reason to expect and no justification for receiving.

The Report does not deny that Delaware has relied on the *Texas* rule, nor the substantial hardship that would befall Delaware if the rule of corporate domicile were overturned. Instead, it focuses on the rule that laches and statutes of limitation do not apply to actions by states, apparently in the belief that the rule has something to do with remedies and therefore should bar any assertion of nonretroactivity here. Report 75 (citing *Illinois* v. *Kentucky*, 111 S. Ct. 1877, 1883 (1991)). But retroactivity of doctrinal change is one thing, and laches and limitations are another. In any event, the doctrine of no limitations against the sovereign is based on "[t]he public interest in preserving public rights and property from injury and loss, [which] justifie[s] a special rule for the sovereign." *Block* v. *North Dakota*, 461 U.S. 273, 294 (1983) (O'Connor, J., dissenting). The doctrine is thus questionable in actions *between* states.[94] We fail to understand what "public rights and property" would be preserved by transferring money properly collected by Delaware under the backup rule to other states which, until they intervened in this case and jumped on the band-

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[94] In actions concerning boundary disputes, for example, the policy is of lesser force, and "the broad policy disfavoring the untimely assertion of rights that underlies the defense of laches and statutes of limitation" is achieved through the application of other doctrines. *Illinois* v. *Kentucky*, 111 S. Ct. at 1883.

wagon of the Master's *sua sponte* rule change, had not even the slightest expectation of ever receiving it.[35]

III. JUDGMENT SHOULD BE ENTERED IN FAVOR OF DELAWARE AND AGAINST NEW YORK

The Report resoundingly rejects New York's theories (purporting to be factual assertions) about the moneys at issue in this case. New York argues that unclaimed property involved in this case determined by the brokers to be "owner/address unknown" should nonetheless be "deemed" to be owed to other brokers, all of whom should be deemed to have "trading addresses" in New York, and therefore that New York is entitled to "a presumption of location based on aggregate statistics." Report 58-59 & n.50; *see supra* p. 19. In short, says New York, these items of cash dividends and interest and share dividends in the brokers' hands are really "owner/address known" and should pass to New York under the primary rule. The Report rejects this position as "inconsistent with *Pennsylvania* v. *New York*, where the Court refused to allow an equally-apt presumption—that the state in which the money orders were purchased was the state of the sender's domicile—to govern. To the extent this is New York's position, judgment against it is entirely appropriate." Report 59 n.50.

Similarly, the Master rejects the entire notion of "trading addresses," noting that "this is not a concept

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[35] Of course, none of this is to say that the *current* rules should not apply to property that New York has wrongfully taken custody of—that is nothing more than the routine application of settled law to the facts of the case. Perhaps the greatest irony of all in the Report is that its recommendations might well result in New York *keeping* what it has taken, in contravention of both the old and the new rules. As a sort of tertiary backup rule, the Report recommends that the state of principal executive office of the *holder* take priority where there is no record that identifies the *issuer*. Report 57, A-3 ¶ 4. The Master did not permit discovery into whether New York has retained records revealing issuer identities, but New York has had no reason to do so under the current rules; to the extent it has not, New York—as the state of principal executive office of many of the brokers and the DTC—will retain the funds at issue in the case.

used in securities law, the Uniform Commercial Code, debtor-creditor law, or the law of personal jurisdiction, venue, or subject matter jurisdiction of the courts. From all that I have been shown, this 'trading address' approach seems to be a conception created out of whole cloth by New York, to favor itself in the instant case—or, perhaps more accurately, to rationalize post-hoc what it has been doing for years." Report 67 n.59.

It was undisputed on the record that brokers and banks cannot identify the creditor who is owed the unclaimed distributions involved in this case. Cirrito Dep. 73 ("any kind of research would really be fruitless"), 128 ("you don't know to whom the monies are due. If you did, you would pay them"), 93-94, 222-23; Shearer Dep. 103, 108-09, 192-93, 198, 213-15, 348-49; Scott Dep. 207-08; Principe Dep. 102-05, 222.

New York's "factual" argument to the contrary does not withstand scrutiny. It asserts that *most* unclaimed distributions are caused by a phenomenon known as "nominee float," where a certificate registered in the name of a broker is endorsed and delivered to a customer in bearer form, is traded from hand to hand in the stream of commerce, and is not submitted to the transfer agent for re-registration for some time. In the meantime, dividends are paid to the broker as the recordholder. *See* N.Y. Motion for Judgment (Oct. 30, 1990) at 56-57 & n.101; Report B-16 to B-17, ¶ 57. New York ignores errors, missed transfers, and out-of-balance record conditions, which are also causes of "owner/address unknown" distributions.[96] But even leaving aside those other causes for "owner/address unknown" distributions, New York's analysis of "nominee float" is unavailing. New York states only that the *first* bearer holder of the certificate could be identified. Griffin Aff. ¶ 2. But it concedes that

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[96] *See* Report B-10 to B-15, ¶¶ 36-51 (describing "Cede float" and other causes of unclaimed distributions), B-16 to B-19, ¶¶ 57-67 (same, for brokers), B-20 to B-22, ¶¶ 73-77 (same, for banks); Cirrito Dep. 223-27; Shearer Dep. 193-96; Principe Dep. 102-03; Scott Dep. 163-67.

the owner of the certificate on the dividend record date or dates cannot be ascertained, N.Y. Motion for Judgment (Oct. 30, 1990) at 30, 56, and that *that* person's identity is the relevant inquiry. *Id.* at 56-57. Moreover, New York argues that the very same "float" problems when encountered at DTC ("Cede float") and at New York banks result in "true" "owner/address *unknown*" funds that may be rightfully claimed by New York *under the backup rule*, since DTC and the banks are New York corporations (N.Y. Motion for Judgment (Oct. 30, 1990) at 30). New York offers no reason why brokers are any different.

The Master's finding of fact on this issue was clearly correct. The funds are "owner/address unknown." Although the Report proceeds to devote considerable attention to demonstrating why New York's "factual contentions are actually beside the point" under the Master's proposed new rules, the Report nonetheless clearly, and correctly, rejects New York's position on the facts.[97]

However, the Report fails to make an alternative recommendation that judgment be entered against New York on the basis of those findings in the event that the Court retains the *Texas* rule as Delaware interprets it. Since Delaware brought this lawsuit to recover the "owner/address unknown" funds that New York has improperly escheated from Delaware brokers under the *Texas* rule, this oversight is more than a semantic one. Delaware is, at this juncture, entitled to judgment against New York, because the Master has correctly concluded that there is no genuine issue of material fact presented by New York's theory. *Cf.* Fed. R. Civ. P. 56(e) (New York has not

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[97] At one point, the Report states that—under its proposed rules—New York should have an opportunity to pursue its factual contentions if it is so advised. Report 67. But the Report is discussing efforts to trace payments "on a transaction-by-transaction basis" to beneficial owners (*not* brokers) who might have last-known addresses in New York, rather than expressing any doubt about the Report's findings of the unacceptability of New York's contentions about "trading addresses" and "statistical showing[s]." *Id.* at 58-59 & n.50; 67 n.59.

"set forth specific facts showing that there is a genuine issue for trial").

CONCLUSION

For the reasons stated, Delaware's Exceptions to the Report of the Special Master should be sustained. The Court should reject the Master's recommendation that the "issuer" should be viewed as the "debtor" even though it has properly paid the dividends and interest to the recordholders, and should reject the Master's recommendation for a change in the definition of corporate domicile. There should accordingly be judgment against the Intervenors. The Court should reject New York's contentions that the property in the brokers' hands owed to unknowns should be "statistically" deemed to be owed generically to "other brokers," and that those brokers should be deemed to have "trading addresses" in New York, and should render judgment in favor of Delaware against New York.

A proposed form of Decree is respectfully attached as Appendix F hereto.

Respectfully submitted,

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